

**U.S. INSURANCE SECTOR: INTERNATIONAL
COMPETITIVENESS AND JOBS**

HEARING
BEFORE THE
SUBCOMMITTEE ON
INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
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U.S. INSURANCE SECTOR: INTERNATIONAL COMPETITIVENESS AND JOBS

Thursday, May 17, 2012

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

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Capito, Dold; Gutierrez, Cleaver, Clay, Watt, and Sherman.

Chairwoman BIGGERT. This hearing of the Subcommittee on Insurance, Housing and Community Opportunity will come to order.

We will get through our opening statements and then hear from all the witnesses, and we thank you.

And thank you, Director McRaith, for agreeing to have the two panels together. I think that this will work out well. So, thank you very much.

And good afternoon. I would like to welcome our distinguished panel of witnesses to today's hearing.

As our subcommittee and others hold hearings, particularly on Dodd-Frank, one distinction has become increasingly clear: Insurance is not banking. We all saw how well the U.S. insurance sector, in contrast to the banking sector, weathered the financial crisis. That point was highlighted in the first annual report issued by the U.S. Financial Stability Oversight Council (FSOC).

Nonetheless, domestic regulators continue to press for a bank-centric model of regulation for insurance providers. And today, we are expanding our oversight beyond our borders to international issues that have created uncertainty for U.S. insurance and reinsurance companies. Are we doing everything that we can to help our American businesses compete, export services, and create jobs here in the United States? I think we can do more.

According to the Bureau of Economic Analysis, in 2011 the United States imported more insurance services than it exported, with U.S. exports totaling \$15.4 billion and U.S. imports totaling \$57.6 billion. Contrast that with the fact that other noninsurance financial services exports totaled \$73 billion and imports totaled \$15.1 billion.

For our insurers and the domestic jobs they create, we must do better. Don't get me wrong, the creation of the Federal Insurance Office, or FIO, which I supported, will help our U.S. insurers com-

pete abroad. And other organizations are working toward the same goal, including the National Association of Insurance Commissioners, or NAIC; State regulators; the U.S. Trade Representative; the Treasury and State Departments; and other insurance trade associations, including the American Council for Life Insurers, the American Insurance Association, the Reinsurance Association of America, and many others.

But we can do more to help our insurers remain competitive and gain access to new markets abroad. According to a 2009 report issued by the U.S. International Trade Commission, liberalization of property-casualty foreign insurance markets would result in greater access for U.S. insurers, billions of dollars in increased sales, and increased employment at U.S.-based companies, among other economic benefits.

That is why during today's hearing, we will examine the international competitiveness of U.S.-domiciled insurance and reinsurance companies. We will hear from witnesses about the opportunities and challenges that regulatory changes, free trade agreements, and state-owned enterprises present to U.S. companies. And we will hear about the activities undertaken by our U.S. insurance experts in a variety of forums that establish international insurance standards and regulations.

I look forward to today's hearing, and again, I welcome our witnesses.

And, with that, I will turn to our ranking member, Mr. Gutierrez, for his opening statement.

Mr. GUTIERREZ. Thank you, Madam Chairwoman, and thank you for holding this important hearing. I also thank the witnesses.

I think it is very important for our Members and the public to learn of the progress that has been made since the creation of the Federal Insurance Office. This is one area of the Dodd-Frank law where there is a great deal of consensus on both sides of the aisle and between the private sector and the Federal Government.

Most observers of the international insurance sector agree that Federal action is needed in order to assist our U.S.-domiciled insurance companies and their global affiliates to achieve much more equitable treatment in the global insurance marketplace. Not including health insurance, we in the United States account for at least 27 percent of all premiums in bulk volume, making the United States the world's largest single country insurance market.

Unfortunately, our exports and even affiliate sales of insurance products do not correspond to our share of premium space. In fact, we have a serious trade imbalance in international insurance, and the United States receives a relatively low proportion of its total insurance revenue from international sources. As with other sectors of the economy, the world is quickly growing smaller and much more complex. The extreme complexity of modern economies presents this Congress, as well as regulators and supervisors, with enormous challenges that need to be met head-on if we are to avoid a repeat of the recent and continuing economic issues.

In order to assist the U.S.-domiciled insurance industry achieve a level playing field both domestically and internationally, Congress created FIO. I am pleased that its first Director, who is here

with us this afternoon, is former State of Illinois Insurance Commissioner Michael McRaith.

And I am glad to welcome you as one of our distinguished witnesses today, Mr. McRaith. I am very much looking forward to hearing your testimony about the achievements of FIO in the international arena during the last few months since its inception.

Madam Chairwoman, I would request unanimous consent to introduce into the record the March 14, 2012, letter from the Financial Services Roundtable to Treasury Secretary Geithner on international insurance issues and the role of FIO.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. GUTIERREZ. Thank you.

I think it is particularly important because this letter does speak to how there really is broad support. It says, "It has been clear for some time that the business of insurance is vitally important to the underpinnings of our national economy and should receive proper consideration at the Federal level. Congress recognized the Federal Government should develop more expertise on insurance issues by including in Dodd-Frank the creation of FIO, and we support full funding and staffing. The establishment of FIO for the first time places an expert in the Department of the Treasury to increase Federal understanding of the business of insurance, an industry that is unique from other financial services, both in terms of its business model and regulatory requirements."

I thank the gentlelady.

Chairwoman BIGGERT. Thank you.

I now recognize the gentlelady from West Virginia for 2½ minutes.

Mrs. CAPITO. Thank you, Madam Chairwoman.

I would like to thank Chairwoman Biggert and Ranking Member Gutierrez for continuing what is an important debate under this subcommittee's jurisdiction, and that is the international competitiveness of the U.S. insurance industry.

I would like to thank our witnesses before us today, and I appreciate their input.

I would like to welcome Director McRaith back to the committee and I look forward to hearing his testimony on the progress of the Federal Insurance Office and his office's representation of the United States in the international community. I am interested to hear how Mr. McRaith uses his office's broad authorities in international matters and also how the office consults with States on issues of domestic and international importance.

We all know that the Dodd-Frank Act was implemented to address the flaws in our banking and security systems that led to the financial collapse of 2008. Throughout that time, however, the insurance industry as a whole was able to uphold a stable presence and was expected to be untouched by many of the laws and regulations implemented in the Act.

Nevertheless, we are seeing that Dodd-Frank could have a far greater impact on many other parts of the economy than anticipated, including the insurance sector. The question for me is, will domestic regulations called for by provisions in Dodd-Frank adversely affect the industry and U.S. participation in the global market?

FIO's voice in international regulatory affairs will be very significant, as effective and globally consistent standards could allow our U.S. markets to grow internationally without losing efficiencies. While the EU is currently modernizing its insurance industry—they have a lot on their hands, I would say—our understanding of how their structure will converge with ours can have a great impact, again, on our competitiveness abroad.

In these deliberations, I think we should be mindful of what is in the best interests of the United States and our consumers. Our system of State-based regulation has proven to be a dependable and important model for the insurance industry, so it is important to keep that in mind when adopting international financial standards. Issues such as heightened capital requirements, varying accounting practices, and assessment of risk are all issues to be considered in an international framework, and how they might inhibit market access.

Again, I would like to thank the Members for being here, and I would like to thank the chairwoman for holding the hearing.

Chairwoman BIGGERT. Thank you.

We have been called for our pesky votes, but I think I will just introduce all of the witnesses ahead of time, so that when we come back, we will immediately start with your testimony. However, we have four bills on the Floor, and the fourth one is the national flood insurance extension, so I am not leaving early from that. That bill is very important.

We have with us the Honorable Michael McRaith, Director, Federal Insurance Office, U.S. Department of the Treasury; the Honorable Kevin McCarty, insurance commissioner, Florida Office of Insurance Regulation, on behalf of the National Association of Insurance Commissioners; the Honorable Steve Bartlett, president and chief executive officer, The Financial Services Roundtable; Mr. Peter Kochenburger, executive director, Insurance Law Center, and associate clinical professor of law and director of graduate programs, University of Connecticut School of Law; Mr. Allan E. O'Bryant, executive vice president, and head of international markets and operations, Reinsurance Group of America, on behalf of the Reinsurance Association of America; Mr. Michael Sapnar, president and chief executive officer, Transatlantic Reinsurance Company, on behalf of the Reinsurance Association of America; Mr. William Toppeta, vice chairman, MetLife, Incorporated; and Mr. J. Robert Vastine, president, the Coalition of Service Industries.

So we will recess and come back after the four votes—I don't know how long it will take, but at least 20 to 30 minutes. Thank you so much.

[recess]

Chairwoman BIGGERT. I think everybody will be back in a few minutes, but let's get started. I am happy to announce that the bill passed. So, that is just one more step in a long road.

Director McRaith, you are now recognized for 5 minutes.

STATEMENT OF THE HONORABLE MICHAEL T. MCRAITH, DIRECTOR, FEDERAL INSURANCE OFFICE, U.S. DEPARTMENT OF THE TREASURY

Mr. MCRAITH. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for inviting me to testify today. I am Michael McRaith, Director of the Federal Insurance Office in Treasury.

First, we know of the interest in our modernization report. I want to acknowledge that it is late. Once it is released in the near future, we trust you will find it to be of appropriate depth and quality.

The Dodd-Frank Act created the Federal Insurance Office, or FIO, and gave it the authority to coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States at the International Association of Insurance Supervisors (IAIS). As an office within Treasury, FIO is well-positioned to express U.S. views and to work effectively with our international counterparts. As we fulfill our statutory mandate, we will work and consult with Commissioner McCarty and his State regulator colleagues as well as other Federal agencies and interested parties.

The insurance sector is critical to the U.S. economy as a risk-transfer vehicle, as a participant in capital markets, and as an employer. As this hearing illustrates, FIO's creation could not arrive at a better time. The United States comprises more than 27 percent of global premium volume and is a major source of revenue for international insurers. The U.S. market itself is growing more international, and insurers generate far more revenue now than ever before from outside the home country. With these realities, the need for Federal Government involvement is clear.

FIO has been involved with the IAIS since last July, and joined the executive committee in February. The IAIS is developing a methodology to identify globally significant insurers. FIO is, of course, also a member of the Financial Stability Oversight Council, or FSOC. At the IAIS, FIO's aim is to shape international consensus so that the IAIS criteria, methodology, and timing are aligned with the Council.

We share industry concerns about the confidentiality of non-public data produced by insurers in support of the IAIS work and will address these concerns in the coming months. The IAIS is developing a common framework, or ComFrame, for the supervision of internationally active insurance groups. We support ComFrame because it will lead to improved cross-border supervision and understanding.

In bilateral matters, FIO established in January an EU-U.S. insurance dialogue that is now led by a steering committee including FIO, our EU counterparts, and State regulators, including Commissioner McCarty. The EU Solvency II framework proposes an equivalence assessment of the U.S. regulatory system, a prospect causing uncertainty for the transatlantic insurance sector.

We initiated the dialogue not to decide a winner, but to compare factually the two regulatory regimes. The steering committee has been engaged constructively and in good faith, meeting twice at Treasury, once in Basel, and next in Frankfurt. Our staffs have

been engaged with information exchange and analyses. After ample chance for public input, we will finish and define the EU–U.S. path forward by the end of this year.

I recently participated in the U.S.-China Strategic and Economic Dialogue, or S&ED, the first of many bilateral exchanges on insurance supervision. Iowa Insurance Commissioner Voss attended the S&ED at Treasury’s invitation, and we enjoyed meeting Chairman Xiang of the China Insurance Regulatory Commission (CIRC). We look forward to fulfilling the commitment between CIRC and FIO to strengthen cooperation in the development and implementation of prudential regulation in the insurance sector. We applaud CIRC’s May 1st announcement that it will open its market to third-party auto liability insurers, and I am optimistic about the growth prospects for U.S. insurers and brokers in China.

Issues in Brazil, Argentina, and India illustrate the need to develop, implement, and enforce international insurance core principles.

To be clear, in every forum, FIO priorities will be a strong American economy, job opportunities for the American people, and market opportunities for U.S.-based brokers and insurers. Chairwoman Biggert, I reaffirm our commitment to work with and to support Congress and this committee on these international topics that are of great local and national importance.

Thank you for your attention. I am happy to answer any questions.

[The prepared statement of Director McRaith can be found on page 57 of the appendix.]

Chairwoman BIGGERT. Thank you so much, Director.

Mr. McCarty, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE KEVIN M. MCCARTY, COMMISSIONER, FLORIDA OFFICE OF INSURANCE REGULATION, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

Mr. MCCARTY. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to testify today.

Chairwoman Biggert, I want to again thank you for participating in our commissioners’ meeting last month. We appreciate your support and leadership.

My name is Kevin McCarty. I am the insurance commissioner of the State of Florida and the NAIC president. I present this testimony on behalf of the NAIC. Today, I will provide the committee with an overview of the NAIC’s involvement in recent international discussions, including standard setting, trade and economic development, and enhancement of regulatory communications.

As the United States is the world’s largest insurance market, with more than a third of the global market share, insurance is key to our economy. State regulators provide international leadership by setting strong standards and developing creative solutions to regulatory challenges while focusing on protecting our policyholders.

As a founding member of the IAIS, State regulators and the NAIC staff serve in various leadership roles, ensuring our system

has a prominent voice as we discuss global insurance principles and standards. We look forward to hosting the IAIS annual conference here in Washington this October.

We were integral in the development of the updated IAIS insurance core principles, which provide the basis for the IMF insurance-sector assessment. When the IMF last assessed the U.S. regulatory system in 2010, it found our strong regulatory system contributed to the overall resilience of the insurance sector during the financial crisis. An IAIS priority is the development of ComFrame for the supervision of internationally active insurance groups. If done right, ComFrame has the potential to create more robust oversight while respecting differences among jurisdictions.

In addition to the IAIS, the NAIC is actively involved in the OECD and the Financial Stability Board and through the Joint Forum, currently chaired by NAIC CEO Dr. Terri Vaughan.

We are pleased to work alongside my friend and colleague, FIO Director Mike McRaith, on many of the international efforts. FIO has an important role as a representative of the Federal Government in these discussions. We are building a constructive relationship, which is crucial since State regulators retain ultimate responsibility for implementing any new international standards. It remains critical that any discussions or agreements on regulatory prerogatives be made with the full cooperation of the States.

The insurance sector plays a significant role in promoting economic development. This demands a level playing field here and abroad in order to create and protect jobs in the United States. With that in mind, international trade and trade agreements are very important. As the USTR negotiates agreements such as the ongoing TPP agreement, and seeks to improve market access for U.S. insurers, the NAIC provides necessary technical expertise and advice.

Our partnership with the USTR dates back to the early 1990s, when NAFTA and GATT were negotiated. In providing expert guidance to the USTR for the last 2 decades, State regulators and the NAIC have sought to promote stable practices and emphasize the successful track record of the U.S. markets. We illustrate to our trading partners the importance of insurance to our economy in terms of jobs, economic output, and risk mitigation for consumers.

Through the NAIC, State insurance supervisors are actively involved in technical assistance programs with foreign regulators. As we consider harmonization of approaches, we must remember that regulatory convergence should focus on outcomes and not prescriptive requirements or structures.

A prime example of our work in this area is the decade-long NAIC–EU regulatory dialogue. These exchanges have been essential to enhancing supervisory understanding between our respective jurisdictions. Just last month, I joined several State regulators and our colleagues from FIO for a week of U.S.–EU events to discuss issues of mutual concern. These exchanges and dialogues are critical to successfully improving the framework for regulation globally.

As we continue to work with our international counterparts, State regulators cannot abdicate our responsibility to consider the impact of regulatory convergence on the U.S. marketplace while en-

sureing that differences in regulations do not become an unnecessary barrier to trade.

In conclusion, increased regulatory collaboration and cooperation enhances well-regulated and competitive markets, providing policyholders better choices and stability. We will continue to coordinate with FIO, the USTR, and our international partners to promote open, competitive, stable, and well-regulated markets around the world.

Thank you, and I look forward to your questions.

[The prepared statement of Commissioner McCarty can be found on page 46 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Bartlett, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE STEVE BARTLETT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FINANCIAL SERVICES ROUNDTABLE

Mr. BARTLETT. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, members of the subcommittee, Mr. Watt, Mr. Hurt, and Mr. Dold.

My name is Steve Bartlett. I am president and CEO of The Financial Services Roundtable (the Roundtable). We are a national trade association of 100 of the Nation's largest banking, securities, and insurance firms. Thirty of our 100 companies are principally in the business of insurance, but I will say that each one of our 100 companies are engaged in the business of insurance in rather significant ways.

Making the U.S. insurance sector more competitive at home and abroad is critical to sustaining our economic recovery. U.S. insurance companies create jobs in every congressional district; finance municipal, State, and Federal investment; help small and large businesses mitigate risk; and support individuals and families when they need it.

And it is really about the economy. Insurance is an essential part of every single element of the economy. Without insurance, people could not drive cars, eat in restaurants, or buy homes; cities could not build bridges or highways; and a company could not build plants or create jobs. So, insurance is not a "want to have;" it is essential.

My testimony will highlight four priorities that I think this committee should focus on and four priorities that will materially affect the U.S. insurance sector's international competitiveness: the role of the Federal Insurance Office; the designation of SIFIs and G-SIFIs; domestic regulations that hinder U.S. competitiveness; and expanding U.S. insurers' access to markets around the globe.

First, the Federal Insurance Office. A strong, effective Federal Insurance Office will enhance U.S. insurers' ability to compete internationally, and they also help U.S. consumers. To that end, The Roundtable publicly and directly supports an increase in FIO's funding, staffing, and levels in stature to the levels contemplated by Dodd-Frank.

FIO can fill the void in international negotiations, a void that has long existed. Section 502 of Dodd-Frank establishes FIO with that international aspect specifically in mind. And I will quote

parts of it: “The office—FIO—shall have the authority to coordinate Federal efforts and direct Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors and assisting the Secretary in negotiating covered agreements.”

Second, SIFIs and G-SIFIs. Designation of SIFIs and G-SIFIs should be coordinated between domestic and international regulators. We shouldn’t have one on one side of the Atlantic, another on the other side of the Atlantic, and a third in Asia. It is important that global regulators not upset the careful work of U.S. regulators designed for domestic purposes to identify SIFIs. International and domestic regulators should coordinate their rules to prevent redundant and conflicting regulations. Applying multiple regulatory standards to international insurance groups would require companies to comply with redundant and often contradictory regulations, would create additional deadweight cost that would be passed along to the consumers, and would deny consumers insurance.

Third, domestic regulations should not be allowed to harm a U.S. insurer’s ability to compete internationally. Specifically, any new capital requirements for insurance companies should be insurance-sector-specific. Administering identical stress tests to insurance companies and bank holding companies confuses the risk profiles of both.

And, fourth, FIO’s expertise will complement USTR’s efforts to eliminate barriers to foreign insurance markets. FIO’s participation in future trade dialogues will increase insurance expertise and enhance the good work of the USTR.

I have a few specific countries I will cite. The Administration should, as they have, and FIO, continue to engage China through the S&ED. The opening of access for China’s auto insurance market was a good step forward, but U.S. insurers still need the ability to open branches concurrently rather than one at a time. And China should be asked to lift its moratorium and clear the backlog for new license approvals for foreign firms offering retirement security products and enterprise annuity and group annuity products. That would be good for the Chinese people and good for the world as a whole. The FIO Director successfully participated in the most recent S&ED, and his influence and presence was felt in a positive way.

The same with Brazil, which in 2010 promulgated some new trade barriers to reinsurance regulations that we need to address and get eliminated. And then last is, India opened its insurance market 12 years ago, but only opened it to 26 percent direct investment, which means it is not open at all.

Madam Chairwoman, uniform, coherent, and strong insurance regulation will impact the U.S. economy in a positive way. And I thank both you and your committee for your efforts in that area.

[The prepared statement of Mr. Bartlett can be found on page 32 of the appendix.]

Chairwoman BIGGERT. I thank you, Mr. Bartlett.

Mr. Kochenburger, you are recognized for 5 minutes.

STATEMENT OF PETER KOCHENBURGER, EXECUTIVE DIRECTOR, INSURANCE LAW CENTER, AND ASSOCIATE CLINICAL PROFESSOR OF LAW, THE UNIVERSITY OF CONNECTICUT SCHOOL OF LAW

Mr. KOCHENBURGER. Thank you. Good afternoon. My name is Peter Kochenburger, and I am a professor at the University of Connecticut School of Law, and the executive director of our school's Insurance Law Center. Thank you for this opportunity to testify today.

I would like to use my time to address two issues: first, FIO's necessary role in representing U.S. regulatory interests internationally; and second, a request that Congress and Federal and State regulators remain vigilant in maintaining important consumer protection standards in the United States as they work closely with their counterparts throughout the world.

Others have very well addressed the challenges insurance regulators face. These include an increasingly global business, historically regulated at the regional and national level, and the traditional segregation of regulatory authority over insurers, depository institutions, investment firms, and other financial services providers.

We can and should acknowledge the tremendous effort and many successes that the NAIC and State insurance regulators have achieved in addressing these challenges, bringing far greater regulatory consistency domestically and representing U.S. regulatory interests abroad. The U.S. insurance sector is by far the largest in the world and one that has suffered relatively minor disruptions over the last several decades, at least compared to our other financial services markets. State regulators deserve much of the credit for this stability.

However, institutionally, only the Federal Government has the authority and national perspective to represent our country's regulatory interests internationally and negotiate insurance-related trade agreements. FIO was established with this specific role in mind when it was created in 2010. And, while still a work in progress, its mission is indispensable and cannot be undertaken by State-based or private entities. The trends that have been discussed here and at many other hearings over the last several years will likely only increase, as will the need for Federal knowledge and participation in various regulatory arenas.

Perhaps the best example I can provide as to why FIO has a vital role to play internationally is the general consensus represented at today's hearing. Rarely have representatives of major insurers, prominent professional organizations, the NAIC, and consumer advocates appeared on the same panel with a similar message.

My second topic is one we have not heard about today, and that is consumer protection. Few would argue with the merits of collaboration and modernization, yet these virtues should not become code words for deregulation, and international cooperation should not be an opportunity or rationale to dilute consumer protection standards in the United States. While insurance regulation in the United States has significant gaps, we also have a tradition of consumer

protection at the State and often the Federal level more rigorous than that found in many other countries.

We do not need to look far in the past to see how these arguments have been utilized previously. The optional Federal charter legislation, a recent modernization initiative put forth by some industry groups, would not only have altered the current and often effective regulatory balance, it would have eliminated important consumer protection standards that have existed for decades.

As international cooperation increases, we will likely hear arguments about how modern regulatory systems in other jurisdictions depend largely on market forces rather than vigilant and empowered regulators to protect policyholders and, therefore, should be imported to the United States. Please be cautious about such arguments. We have heard them before and often with ill effect when adopted.

I do not say this to be critical of an industry that is not only necessary to our country and economy but also one which has served it with honor. However, while enlightened industry's self-interest is to be expected, we cannot accept on their face the positions it advocates, which should be carefully reviewed.

State insurance regulation creates delays and duplication of effort by both the insurance industry and insurance regulators. That is indisputable. However, we have a constitutional structure that acknowledges significant State regulatory authority, and Federalism necessarily assumes a certain degree of duplication and inefficiency. The question is whether these costs are worth the benefits, not whether the existence of these costs is an excuse by itself to reduce State regulatory control.

The benefits of insurance cannot be overstated, but their importance is exactly why it is necessary to regulate it carefully to ensure that policyholders obtain their benefit of the insurance bargain. The primary focus in evaluating insurance regulation, whether internationally or at the domestic level, should not be on market efficiency or claims of international comity but on effectiveness in protecting policyholders and our national economy.

Thank you for your time.

[The prepared statement of Professor Kochenburger can be found on page 38 of the appendix.]

Chairwoman BIGGERT. Thank you.

I now recognize the gentleman from Missouri, Mr. Clay, for an introduction.

Mr. CLAY. Thank you, Madam Chairwoman, and thank you for conducting this hearing.

I would like to welcome Mr. Allan O'Bryant from the Reinsurance Group of America (RGA). RGA is headquartered in my home State of Missouri, and has over 700 employees and growing in Missouri, and a total of over 1,700 employees worldwide.

Mr. O'Bryant, I know you head up RGA's international markets and operation and have flown all the way from Japan to join us today.

Mr. O'Bryant technically covers all international, but given that he is based in Japan, his focus is more on Asia, where he is in charge of, at a minimum, Japan, Hong Kong, Korea, India, Malaysia, Taiwan, Thailand, and China.

Thank you so much for making such a long trip and for providing your valuable input today. We look forward to your testimony.

And I yield back, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

And thank you so much for that trip to come here, Mr. O'Bryant. You are recognized for 5 minutes.

STATEMENT OF ALLAN E. O'BRYANT, EXECUTIVE VICE PRESIDENT, AND HEAD OF INTERNATIONAL MARKETS AND OPERATIONS, REINSURANCE GROUP OF AMERICA, INC. (RGA), ON BEHALF OF THE REINSURANCE ASSOCIATION OF AMERICA (RAA)

Mr. O'BRYANT. Thank you.

Thank you, Congressman Clay, for the introduction.

I am testifying today on behalf of the Reinsurance Association of America, a national trade association representing life, property, and casualty reinsurers. And I would like to thank Chairwoman Biggert and Ranking Member Gutierrez for holding this important hearing today.

RGA is the largest U.S.-based life reinsurer. Our products include individual and group life reinsurance, living benefit reinsurance, and specialized underwriting to help individuals with unique health problems obtain the life insurance coverage they need to protect their families. We are headquartered in St. Louis, Missouri, and have operations in 25 countries.

Our clients are many of the life insurance companies you hear about every day. Insurers use our services to promote their volume of business, reduce volatility from catastrophic events, help meet regulatory requirements, and enhance their general financial strength. Reinsurance is truly a global product. Indeed, 49 percent of the life insurance RGA reinsures is for persons living outside the United States.

Today, I would like to address three issues crucial to the life insurance sector's, or the U.S. insurance sector's, international competitiveness and our ability to expand abroad while creating more jobs here at home: first, the need for a level playing field in international reinsurance laws and regulations; second, the challenges of competing with State-owned insurance and reinsurance companies receiving preferential treatment; and third, the positive impact of free trade agreements on insurance and reinsurance.

In addition to those issues, the RAA strongly supported the establishment of the Federal Insurance Office. The international competitiveness of U.S.-based firms depends in part on a functioning governmental entity empowered to engage foreign governments and regulators on insurance and reinsurance matters and to advocate on behalf of U.S. consumers and companies operating abroad. We are encouraged by Director McRaith's participation in the EU-U.S. transatlantic dialogue as well as the meeting of the International Association of Insurance Supervisors.

Reinsurance is a global business. Insurance laws and regulations in foreign markets should not favor local insurers and reinsurers over multinational or U.S.-based companies like RGA.

For example, some markets abroad have so-called seasoning requirements essentially barring companies from obtaining licenses

until they have been in business for a prescribed number of years. This requirement does not bring about healthier insurance markets because it is blind to other virtues of a company, such as the quality of the assets or of its management team. Rather, it limits the number of companies able to provide services, resulting in a less efficient, less competitive insurance market.

Regarding oversight, we agree that supervision of insurance groups should be improved. However, creating unified standards only for a select group of insurers and reinsurers is setting a double standard.

In the domestic market, we look to our insurance regulators and officials to ensure that U.S.-based insurers can also compete on a regulatory level playing field here at home. To this end, we recommend that the FIO be required to use its ability to preempt State measures to ensure competitive equivalence in the U.S. market between U.S. and non-U.S.-based firms. Under Dodd-Frank, FIO can only preempt State measures that discriminate against U.S. companies. There is nothing in the law ensuring that U.S.-based firms will not be discriminated against.

Second, competing with the government-owned insurance and reinsurance companies abroad is proving to be a problem in many important emerging markets such as China, India, Brazil, and Korea. There should be equal regulatory treatment of private and state-owned insurance and reinsurance firms, but this isn't always the case. State-owned companies frequently benefit from more lenient supervision. What is more, if the International Association of Insurance Supervisors eventually sets higher standards of scrutiny, entities in these countries may be excused from new standards if they only operate in one or two countries. While we do not object to state-owned insurers and reinsurers, standards need to be applied equally.

And, finally, we applaud the free trade agreements with Korea, Colombia, and Brazil. Benefits can include protection and enforcement of agreements to protect confidential information exchanged between U.S. and foreign insurance regulators for proper regulatory oversight. We are especially hopeful that the privacy and data transfer provisions of the U.S.-Korea Free Trade Agreement will address the differences in data protection rules currently existing between the United States and Korea. The test of these agreements will be in the creation and the enforcement of laws and regulations within each participating country consistent with the terms of the agreement.

Thank you again for the opportunity to comment on these issues, and I look forward to your questions.

[The prepared statement of Mr. O'Bryant can be found on page 64 of the appendix.]

Mr. HURT [presiding]. Thank you, Mr. O'Bryant.

Mr. Sappanar, you are recognized for 5 minutes. Thank you.

STATEMENT OF MICHAEL C. SAPNAR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TRANSATLANTIC REINSURANCE COMPANY, ON BEHALF OF THE REINSURANCE ASSOCIATION OF AMERICA (RAA)

Mr. SAPNAR. Good afternoon. My name is Mike Sapnar, and I am the CEO of Transatlantic Reinsurance Company. I am here on behalf of my company and the Reinsurance Association of America. I am grateful for the opportunity to address the subcommittee on the impact of regulatory impediments on U.S. reinsurance companies.

As you know, there is not a long list of U.S.-domiciled reinsurers with global operations. Our written statement details the reasons why this list is short. That aside, I would like to focus my comments using Transatlantic as a practical example on four of these issues: increased protectionist regulatory policies abroad; increased regulatory oversight of reinsurance abroad; the historical absence of a Federal advocate for reinsurance in the United States; and the tax disadvantage of U.S.-domiciled reinsurers.

First, there are two facts that underscore the gravity of these issues. One, there were five major worldwide property catastrophe losses in the last 24 months, totaling over \$125 billion. Sixty-two-and-a-half percent of these losses will be paid by reinsurers, and 97 percent of that amount will be paid by reinsurers outside the country in which the loss occurred. Two, of the 50 new global reinsurers formed since 2001, exactly none were formed in the United States. In fact, since 1989, no new global reinsurer has chosen the United States as its home domicile.

Transatlantic, founded in 1978, is the leading global property and casualty reinsurer domiciled in and regulated by the State of New York. We are licensed in all 50 States as well as in many countries around the world. We have one main operating company in New York and a global network of 17 branches. This structure provides a strong single-balance-sheet approach, allowing us to deliver a cost-effective product while offering local service and superior financial security.

Despite the global capital role that reinsurance plays, Transatlantic has encountered protectionism policies in many foreign jurisdictions, notably Asia and Latin America. These barriers include: limitations for foreign companies on direct investments and domestic entities; mandatory cessions by local reinsurers to specified reinsurers; right of first refusal for domestic reinsurers; punitive minimum capital requirements; and restrictions on cross-border flows. Often, the countries imposing these barriers are emerging insurance markets.

Transatlantic does not suggest that the United States consider retaliatory policies. Instead, our collective goal should be to educate developing insurance markets on the value of free trade, regulation without strangulation, and the syndication of risk. We believe the Federal Insurance Office can play an important advocacy role on this issue and elsewhere.

In particular, the FIO can play an important role in helping U.S. companies address overseas regulatory issues. Following the 2008 financial crisis, foreign regulators are more aggressive in how they oversee U.S. reinsurance branches. One such example is the pro-

posed implementation of the EU's Solvency II directive and its threat to our operations.

We have three branch offices in Europe operating off our single balance sheet; thus, we do not have to segregate our capital. This mitigates infrastructure costs, currency issues, and value-added taxes. In addition, clients receive local service while tapping our full financial resources. Regulators, meanwhile, can interface with local company contacts and readily access records for inspection and oversight.

Nevertheless, the U.K. regulator has pointed to the fact we do not have a solitary U.S. insurance regulator to coordinate with when setting the strategy for the regulation of U.S. reinsurance branches under this new directive. They noted that regulation of U.S. insurers varies by State. They felt their only options were to either apply their own regulatory scheme on an extraterritorial basis or require a separately capitalized subsidiary in the EU which could be consistently regulated under Solvency II.

With this new approach, Transatlantic faces a difficult choice: close our U.K. branch to avoid dual regulation by the U.K. FSA and the New York Department of Financial Services or establish a U.K. subsidiary with separate infrastructure, capital, and increased costs.

Ironically, during this same period, the NAIC in several States was focused on relaxing the regulation of foreign reinsurers. Thus, while U.S. companies are faced with heightened requirements in the EU, U.S. regulators are lowering barriers at home.

An active FIO would serve three purposes here: one, advocate on behalf of all U.S.-domiciled companies for fair treatment in international jurisdictions; two, provide a single gate for foreign regulators to interface with U.S. insurance regulators; and three, coordinate policies at home with issues abroad. We cannot stress enough the potential value in these three areas of a well-resourced single U.S. regulator.

Finally, the United States needs to narrow the tax disparity. The United States has the highest corporate tax rate in the world, combined with the punitive treatment of controlled foreign corporations. Companies like us face a higher cost of capital over time. Lowering the tax rate or amending the taxable base will not only allow domestic companies to better compete globally; it will encourage new or existing reinsurers to locate here. In fact, a revised corporate tax structure with an empowered Federal advocate would be a compelling environment for many reinsurers, which would bring both jobs and capital to the United States.

Thank you very much.

[The prepared statement of Mr. Sapnar can be found on page 76 of the appendix.]

Mr. HURT. Thank you, Mr. Sapnar.

Mr. Toppeta, you are recognized for 5 minutes.

**STATEMENT OF WILLIAM J. TOPPETA, VICE CHAIRMAN,
METLIFE, INC.**

Mr. TOPPETA. Thank you, Mr. Chairman, and members of the subcommittee. My name is Bill Toppeta, and I am vice chairman of MetLife.

You likely know MetLife as the largest life insurer in the United States. In recent years, we have grown to be a leading global provider of life insurance, annuities, and employee benefit programs, serving 90 million customers in over 50 countries.

In 2011, our businesses outside the United States contributed approximately 35 percent of MetLife's earnings. I am here today to speak on behalf of a level regulatory playing field for U.S. insurers throughout the world.

Our recommendations are straightforward. First, policymakers should carefully weigh the impacts of duplicative or conflicting regulations. Second, insurance should be regulated as insurance, not as banking. And third, policymakers should address non-tariff barriers impacting insurers operating abroad through trade agreements and intergovernmental dialogues.

It is hard to imagine an industry that has more layers of regulation than life insurance, and that situation appears to be getting worse, not better. Although we favor good, strong regulations, multiple layers can actually be self-defeating, to say nothing of confusing and expensive.

The intersection of international and domestic policies and standard-setting creates an increasingly complex global regulatory environment. Duplicative or conflicting regulations may inhibit growth and fail to address the very issues they were intended to cure. This situation may negatively affect the competitive position of U.S. insurers.

I will provide a couple of examples to illustrate my point. One is the Solvency II directive in the European Union. A component of Solvency II is a greater focus on group supervision. Since many EU insurance groups also have businesses in other countries, the EU proposes to assess the equivalence of these third-country supervisory regimes.

It will not surprise you to learn that, as a large U.S.-based insurer with operations in Europe, MetLife would like to see the EU recognize the U.S. as equivalent for Solvency II purposes. We would argue that regulators should focus on the outcomes provided by regulation rather than on the structure of the regulatory system. We are wary of premature arguments for regulatory convergence. What we need at this stage is consistency achieved through mutual recognition of the outcomes of our respective systems, rather than pressure to replicate or adapt models from other countries.

Congress is in an excellent position to elevate the U.S.-EU dialogue on equivalence. The congressional spotlight can be shown on the benefits of mutual recognition which flow to consumers, EU and U.S. businesses, regulators, and our two economies. Whenever transatlantic dialogues take place, it will be helpful to hear a chorus of congressional support for cooperation on insurance regulation. The world's two largest insurance markets deserve the level playing field that will come from mutual recognition.

Let me turn now to a trade example. One of the ways countries seek to protect their domestic industries is by restricting foreign direct investment in certain sectors, usually for a limited period of time. Two of the world's largest markets, India and China, maintain tight restrictions on FDI and life insurance. In India, foreign insurers are limited to 26 percent ownership, and in China, the

limit is 50 percent. This means that companies like MetLife who operate in two of the world's fastest-growing markets must identify local partners to invest in and jointly govern their operation. No similar restriction applies to Chinese or Indian companies operating here.

FDI caps are particularly challenging for life insurers because we must commit substantial capital not only to bricks and mortar, marketing and distribution of our product, but even more so to backing up the financial guarantees we make to our customers. The initial investment period for starting up new life insurance ventures can span several years, and local investors may not always have the patience or the capital to sustain such long-term investment.

Reduction or elimination of FDI caps in these key markets will take the concerted effort of our government through all available channels. Congress is in an excellent position to keep the spotlight on this issue and to support ongoing efforts by the White House, USTR, and the Departments of State and Treasury to eliminate or reduce FDI caps.

Let me conclude by affirming that American companies are innovative, and American workers are highly productive. Given a fair chance, with a fair, level regulatory playing field, we can compete and win against anybody in the world.

Thank you for your attention, and I look forward to your questions.

[The prepared statement of Mr. Toppeta can be found on page 93 of the appendix.]

Mr. HURT. Thank you, Mr. Toppeta.

Mr. Vastine, you are recognized for 5 minutes.

STATEMENT OF J. ROBERT VASTINE, PRESIDENT, COALITION OF SERVICE INDUSTRIES (CSI)

Mr. VASTINE. Thank you very much, Mr. Hurt, and thank you, members of the subcommittee.

For the record, I would like to thank Chairwoman Biggert for her work as co-chair of the Congressional Services Caucus. We deeply appreciate her and her staff's understanding of the importance of the services sector, the country's biggest employer.

The United States is the world's largest services exporter. Exports reached \$588 billion with a surplus of almost \$200 billion in 2011. That is a new record. U.S. cross-border insurance exports, as the chairman pointed out at the outset, accounted for only 2.6 percent of those exports, or about \$15 billion. But insurance cross-border exports understate the very substantial role of our insurers in global markets through overseas affiliates, where sales were \$60 billion in 2009 in official statistics. We have reason to believe that this is an understatement in itself.

Although our exports are strong, a recent study by Dr. Brad Jensen at the Peterson Institute estimated that the United States has the potential to export far more and that 3 million more U.S. jobs could be created if we can remove the many complex foreign barriers to our services trade. And here is where we certainly need the coordinated help of the FIO and the U.S. Trade Representative and other agencies.

CSI was founded 30 years ago to bring services to the forefront of the U.S. trade agenda, and we believe we have achieved that goal. And so, it is appropriate to appear today with Bill Toppeta, our chairman.

There are now numerous opportunities, new opportunities in which CSI and its members vigorously engage to promote insurance trade and investment, including the International Services Agreement being discussed in Geneva, the Trans-Pacific Partnership being negotiated this week in Dallas, the U.S.–EU High-Level Working Group, as Bill has described it, and there are others.

In all services negotiations, the most important objective is to achieve access to foreign markets. And this means the right to establish your business, to own it fully, to use the corporate forum most suitable to the market, and to operate in a transparent regulatory environment. Equally important is the right to get the same regulatory treatment that a local company gets. This is, of course, known as national treatment.

A recent example of a market access issue on which progress has been made is that of the auto insurance market in China. After years of engagement by the U.S. Government and industry, China finally agreed to open this market—recently at an S&ED conference, actually. More work must be done to make the promise a reality. We deeply appreciate the work of the U.S. negotiators who will, we are sure, secure this commitment.

Bill Toppeta has mentioned the issue of equity caps, and I won't repeat those. In China, in India, and in other markets, equity caps are a major deterrent to foreign direct investment and to local economic growth.

In addition to these market access issues, we are now confronting what we call our 21st-Century issues. One of the most important of these is foreign government policies that favor state-owned enterprises—for example, national postal services. The sale of insurance through post offices is a growing problem. For instance, Japan Post is a 100 percent government-owned postal entity that offers regular mail service but also insurance and banking and other services, which all are in direct competition with private sector companies, including our companies. The Japanese Diet recently passed legislation that will expand the favorable treatment provided to Japan Post insurance and make it easier for it to offer products on a discriminatory basis.

CSI and the U.S. Chamber of Commerce have collaborated recently to bring to the forefront this issue and to actually table language—to urge our government to table language which is now being discussed in the Trans-Pacific Partnership negotiation as a foundation for a global standard.

Freedom of data flows is absolutely essential, and it is another 21st-Century issue. It underpins our huge services exports. Our roughly \$600 billion of services exports depend on the ability of data to move. Digital trade, we call it—digital enablement of services trade.

For example, many countries are attempting to require that all financial services data, including insurance data, be processed and stored in-country. The Korean agreement, as has been pointed out, for the first time contains the provision that insurance companies

may process data outside Korea. Again, our negotiators in the TPP are working to ensure that requirements are not placed on the location of servers and that data flows are not unnecessarily interrupted.

Finally, another 21st-Century issue is forced localization, which occurs when a country requires multinational companies to conduct their business activities domestically, requiring that business processes or hiring be conducted in-country. For instance, Brazil is forcing the localization of reinsurance, and Argentina has taken many steps to force global insurances to localize within that country.

All of these issues and more demonstrate the necessity of the FIO and the trade agencies and the huge agenda ahead. Thank you very much.

[The prepared statement of Mr. Vastine can be found on page 104 of the appendix.]

Mr. HURT. Thank you, Mr. Vastine.

I will now yield myself 5 minutes.

I wanted to see if I could get an answer from Mr. Toppeta and Mr. Bartlett on this question, and then maybe also hear from Mr. McRaith and Mr. McCarty.

As we look at, in the future, the designation of certain companies as SIFIs and G-SIFIs, I would like to know specifically what concerns the industry has in terms of recognizing the difference in the business models between banking and insurance? And what should we be looking at toward minimizing the consequence of those designations in terms of global competition?

If we could, Mr. Toppeta, and then Mr. Bartlett. And then, if we have time, I would love to hear from Mr. McRaith and Mr. McCarty.

Mr. TOPPETA. Thank you, Mr. Chairman.

I would say this: The basis of all of this is that the business models of banking and insurance are considerably different.

In insurance, we start with our liabilities. We start with the promises we make to our policyholders, and those are our liabilities in the future. We have to then match those with long-term assets. Because we make long-term promises that we are going to pay on 20 or 30 years in the future, we have to have long-term assets to go with them.

We do not have the same business model as banks who borrow money short, in effect, and invest long. We do not have the same liquidity issues that banks have. Banks can suffer literally runs on banks, where customers come in and ask for their deposit. We have in our policies protections against that so that we have surrender charges, penalties if someone is going to surrender early; there are tax consequences of surrendering early.

So I would say the two business models are different. And, therefore, in all of our regulations, we have to make very sure that we are regulating insurance as the business of insurance, not as banking.

Mr. HURT. Thank you.

Mr. Bartlett?

Mr. BARTLETT. The business models are entirely different. The Dodd-Frank and SIFIs were written, in all fairness, primarily with the banks and bank holding companies in mind. But, nevertheless,

it did mandate to the Treasury and to the FSOC to consider all types of financial institutions, and so that is what they are going to do.

There are a lot of tests in the law as to what makes a SIFI, but the biggest one, it seems to me anyway, is interconnectedness. And we have all spent a lot of time commenting on that, but interconnectedness sort of takes center stage in that.

I think what is facing FIO now—and I believe FIO is and should concentrate on this—is to be sure that the G-SIFIs in Europe and SIFIs in the United States, that definition is as close to exactly the same as possible or at least quite concurrent and quite compatible. It is hard enough to figure out what is an interconnected, systemically risky company, but if you have to have figure that out with two different definitions on two sides of the Atlantic, then it would create confusion and add to systemic risk rather than diminish it.

Mr. HURT. Thank you, Mr. Bartlett.

Mr. McRaith?

Mr. MCRAITH. Yes, Mr. Chairman. To add to what the prior panelists have said, if we look at what happens when a traditional bank fails and when a traditional insurer fails, that really depicts the most graphic difference. If a bank fails, there is the potential for an immediate run on all assets of that bank. And the liquidity problem may mean the bank doesn't have sufficient liquidity to meet the demands of the run. When a traditional insurance business fails, not every car owner, for example, is going to get into a car accident immediately upon failure. Not every individual is going to seek death when its life insurer fails. So, there is not that same prospect of a run. They are very different business models with very different consequences in the event of failure.

At the Federal Insurance Office, we are not only involved with the Financial Stability Oversight Council, we are involved at the IAIS, where the process is being developed to identify globally significant insurance institutions. We are working to align the criteria, the methodology, and the timing of both of those processes so that no U.S.-based insurer is disadvantaged through the global designation process.

Mr. HURT. Mr. McCarty, would you like to just comment briefly? My time is about up.

Mr. MCCARTY. Yes, and I will make this brief, Mr. Chairman.

I do agree that not only is the business model different, but the regulatory model is different and has a stringent regulatory regime. And it also, because of the nature of insurance, gives more opportunity for the companies to rebound and not have the same reaction that you would in the case of a bank.

We contend that banks have historically been risky, systemically risky, when traditional insurance has not been. And we would think that the solution would be to wall off the insurance entities to prevent them from being systemically risky.

Mr. HURT. Thank you, Mr. McCarty. My time has expired.

I recognize Mr. Clay from Missouri for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

Mr. O'Bryant, what types of barriers to entry in the foreign markets have U.S. firms faced? And could you give any particular in-

stances or identify countries where it may be more difficult to enter those markets?

Mr. O'BRYANT. Yes, Congressman Clay. One barrier that we are actually considering and facing right now is with the country of Brazil. Just in the last year-and-a-half, they have strengthened their own internal requirements that require more of any type of reinsurance be allocated to the state-owned insurance reinsurer. That, along with high capital requirements to enter the market, make that market extremely difficult for us to enter into and to be profitable. So, it actually limits the capacity that we could offer to local insurers to write more business.

Mr. CLAY. And would you share with us your recommendations to correct some of the barriers? How would you recommend it being done differently?

Mr. O'BRYANT. All the gentlemen on the panel, almost, have addressed the need for a strong voice that could represent the industry from a Federal level.

I have worked in Japan for many years, and I was around in 1996 and 1998 when the USTR represented the United States in insurance talks with Japan. One of the things I heard from the regulators, Japanese regulators, the Ministry of Finance at that time, was that there was no one who would really speak on our behalf who knew what we were talking about or what they were talking about. Not that the USTR was an unfit negotiator, but they did not look at it from the perspective of the insurance industry. Whereas, when they were negotiating banking treaties, the Treasury negotiated on behalf of the U.S. banks.

So, the FIO is very important to us as an industry. As a Federal representative, it is empowered to represent the industry and conclude treaties.

Mr. CLAY. Thank you for that.

And along those same lines, I want to say that another witness mentioned the concept of a Federal advocate for reinsurance companies. Could someone expand on that?

Mr. Sapnar?

Mr. SAPNAR. Yes, that was me.

Mr. CLAY. Okay.

Mr. SAPNAR. I think, for us, a lot of the international regulators that we deal with don't understand the U.S. regulatory system very well. And to have an advocate or a single gateway where they can go and have a single liaison with the different States would be useful, considering that different States have different regulatory regimes.

And I would just go a step further. Last week, I think, David Cameron, U.K. Prime Minister, sat out in front with Lloyd's and talked about the importance of the Lloyd's market and the long-term strategy of Lloyd's. And I think having a Federal advocate for our business and promoting the transparency and the financial strength of our—and the successful regulatory system we do have here that isn't well understood would go a long ways overseas.

Mr. CLAY. And, Mr. Sapnar, you piqued my interest when you talked about U.S. tax structure and if it was competitive with the rest of the world. I was wondering, if it was competitive, if it was lower rates, would your company be receptive to repatriating your

profits that you earn overseas and bringing them back here and paying a fair tax on those profits and reinvesting them in this country?

Mr. SAPNAR. Sure, I will talk about that on two levels.

First of all, yes, we already do that as a branch system. So, the profits we earn overseas are consolidated under our New York office, and we pay full tax on that.

Second, last year we went through a situation where we were being merged with another entity that was a Bermuda-based company. During that process, four other companies eventually emerged wanting to buy Transatlantic. Why did they want to buy Transatlantic? Because if they could get our capital and our assets offshore, it was a big coup for them. So, clearly, other people see that, and that is a potential threat to jobs here in the United States or Transatlantic staying on shore.

We did ultimately choose, as a management team, to combine with a U.S.-based company for other reasons that were compelling, in my view, at the end of the day, but I had to answer to the shareholders.

Mr. CLAY. Okay. Thank you for that response.

I yield back.

Mr. HURT. Thank you, Mr. Clay.

Mr. Dold is recognized for 5 minutes.

Mr. DOLD. Thank you, Mr. Chairman.

And I certainly want to thank all of our witnesses for being flexible today and for coming from great distances to join us.

I also want to welcome all of our former committee staff who happen to be in the audience today. We certainly appreciate you being with us.

Mr. Chairman, I was obviously on the Floor when we started on opening statements, and I would like to ask unanimous consent that my opening statement, which I was unable to give, be submitted for the record.

Mr. HURT. Without objection, it is so ordered.

Mr. DOLD. Thank you, Mr. Chairman.

Director McRaith, it is so great to see you again. I hope all is going well. I thought we would just start with you.

The other two insurance experts on the FSOC, Mr. Woodall and Missouri Insurance Commissioner John Huff, have both said that they didn't think that the traditional property casualty insurance could be deemed systemically significant. In fact, in July, Mr. Huff actually testified before this subcommittee and said that traditional insurance products and activities do not typically create systemic risk.

As the FIO Director, the Dodd-Frank Act charges you with making recommendations to the FSOC on insurance companies to be designated for the heightened prudential standards and supervision by the Federal Reserve. Do you foresee the FIO recommending to the FSOC or any equivalent international body that any insurer be deemed systemically significant?

Mr. MCRAITH. The Financial Stability Oversight Council, by statute, looks at all firms that may present a vulnerability or threaten the health of the economy. It does not afford the Council the opportunity of exempting any one industry or sector. In that process, I

know the Council is evaluating large firms that have many different business components. While the traditional business of insurance may not, in itself, present systemic risk, that is not a reason not to look at a larger firm.

I would not disagree with the statements that Director Huff and Mr. Woodall have made. I would say that I think, as a country, it is clear that we need to always evaluate a firm as a whole, “look under the hood,” as they say, and evaluate what are the nontraditional insurance aspects of that firm’s operations.

Mr. DOLD. And I certainly believe that is fair. Are there any firms that you can think of right now, insurance firms, that you think potentially you would recommend to the FSOC as systemically significant?

Mr. MCRAITH. No, but I would—looking at history, of course, we could look at AIG—

Mr. DOLD. Sure.

Mr. MCRAITH. —a firm that was predominantly known as an insurance firm. That would be a firm, if we were to go back several years, we would like to be designated.

Mr. DOLD. Director McRaith, I don’t disagree. My question to you on AIG is, property and casualty, was that part of the issue with AIG?

Mr. MCRAITH. I don’t want to comment on any firm today, but—

Mr. DOLD. Sure.

Mr. MCRAITH. —I would say, looking back at AIG, historically, there were issues in some of the insurance—

Mr. DOLD. No question, there were issues.

Mr. MCRAITH. Yes.

Mr. DOLD. I just think that if we look at it on the aspects of their business, if we have a traditional property and casualty insurance business, generally those weren’t really the issues. And I understand your need to try and look under the hood, and I think that is certainly good. I just wanted to see if you had any on the top of your mind right now.

If I can, I would just like to switch to Mr. O’Bryant. Thank you again for making the trek in as long as you have. The question I have for you is, you expressed concern in your written testimony about the reinsurance of certain term life insurance products because the United States has strict reserving rules for such products that are not present in many other countries. Further, you suggest that if the FIO does not address this disparity, a number of U.S. firms would be disadvantaged in their ability to offer competitive prices to reinsure such products.

What specific recommendations, if any, would you have for Director McRaith, the FIO, to address this concern?

Mr. O’BRYANT. Thank you for the question.

Again, I think the most important thing is to have a strong advocate that can use the U.S. model and the strength of the industry.

One of the things we enjoy from the State regulators is a very strong and prudent model that has protected the industry and protected the consumers and policyholders for many years. And it has shown that reserving requirements here are indeed substantial and, because of the long-term results of reserving standards here, that they have applicability worldwide.

But I think having the one voice that can advocate the same type of standards and same type of solvency requirements is the greatest strength that we could ask for.

Mr. DOLD. I certainly thank you for the comments.

Mr. Bartlett, I had a question. My time has expired, so I will submit that in writing to you.

But, again, thank you all for taking the time to join us today.

Mr. HURT. Thank you, Mr. Dold.

Mr. Cleaver is recognized for 5 minutes.

Mr. CLEAVER. I will yield to the gentleman if he would like to—not completely, but—

Mr. DOLD. No, no, just for the question.

Mr. CLEAVER. Yes.

Mr. DOLD. I do appreciate that. I thank my friend for yielding just for the question.

Mr. Bartlett, in your testimony, you applauded the Chinese Government's announcement that it would lift the prohibition on foreign firms offering mandatory auto insurance policies.

Are there other restrictions that impede U.S. competitiveness in China that the Administration can address through its Strategic and Economic Dialogue?

Mr. BARTLETT. Thank you. I will be brief.

Yes, of course, it is China, so there are a lot of restrictions. Auto insurance was another step forward. The two that come to mind is, one is that U.S. insurers need to be able to open branches concurrently. It would be like saying that you can offer a new brand of fertilizer for soybeans but only one field at a time per year, and that wouldn't get you very far very fast.

And then second is to lift its moratorium on license approvals for foreign firms offering annuities and retirement products. That would be astoundingly positive for the Chinese themselves as well as for global trade.

Mr. DOLD. Thank you, sir. I appreciate it.

And I appreciate my friend for yielding.

Mr. CLEAVER. Thank you, Mr. Chairman.

Let me go with Mr. O'Bryant and Mr. Bartlett, not just because they have a big operation in Missouri, but—I am wondering, Mr. O'Bryant, what specifically can the Federal Government do to help companies like yours? Now, the follow-up is dangerous, but go ahead. What can we do to help companies like RGA?

Mr. O'BRYANT. As we enter new markets, the greatest challenge that we have is local regulations. Clearly, the standards are different from those that we have here at home. And our whole entire business model is built on providing additional services to expand the ability of local insurers, as well as multinationals in those countries, to offer products to a greater number of people through our specialized underwriting capabilities as well as to inject new knowledge through product development ideas in those countries.

But because of the barriers that we find, often because of capital that is required—and, as Mr. Sapnar said, in many cases, we are required to set up localized companies instead of being able to work through branch structures. And then also, in many cases, as I mentioned earlier, in Brazil, where there are requirements that the state-owned company receive a greater portion of any kind of ceded

premium, it restricts our ability to move into those markets, and it actually helps local companies expand their companies.

Mr. CLEAVER. So the follow-up would be—and you may have answered this—what is it that we are doing presently that you believe to be the greatest impediment to RGA? Either you or Mr. Bartlett or both?

Mr. BARTLETT. What I have communicated clearly with Mr. McRaith and with others is that I think the greatest challenge and the single place that we can advance the cause of the American consumer the most is with uniform standards from State to State, to create equal protection of the laws in every State. The American people, both consumers and businesses, are highly mobile. They are interstate, they are interconnected, and they deserve the opportunity to have a uniform set of standards.

We are a long way from that, and it can be happening in incremental steps, but I think that is one of the challenges for FIO in which they can advance the cause for the American people by a lot.

Mr. CLEAVER. Mr. Sagnar?

Mr. SAPNAR. Thank you.

I think Director McRaith has a unique opportunity, difficult in being the first Director as well, but he has some abilities or authorities that the States don't have, and we historically haven't had in the United States, to enter into some agreements with foreign regulators that are binding.

And I think that the biggest problem we face is we have 50 different States that are hard for our overseas regulators to understand. And if he can get down to settlement of those issues, rather than discussions of principles, we think that would be a really good thing at the end of the day.

That is very difficult for him. He has a lot to do, there is a lot going on, so he needs the support. We are prepared to support him and to educate the office as much as possible. I am not suggesting it is easy, but I think it is certainly possible.

Mr. CLEAVER. Thank you.

Mr. HURT. Thank you, Mr. Cleaver.

Without objection, I would like to recognize myself for an additional 5 minutes to ask questions of Mr. Vastine and Professor Kochenburger.

We have heard concern about the European Union's Solvency II initiative, and I would like to hear from you about whether or not you believe that initiative will put U.S. insurers at an unfair disadvantage. And how would you recommend to minimize that unfair advantage?

If I could have Mr. Vastine address that question, and then, Mr. Kochenburger, if you could also weigh in. Thank you.

Mr. VASTINE. Solvency II is obviously an enormous concern to our country, and it does pose competitive issues that the industry is engaging in a very intense way with regulators in Europe and with the help of Mr. McRaith.

So I think the response of the industry has been, in the context especially of the EU-U.S. High-Level Working Group, to more actively and thoroughly engage the Europeans in a dialogue that will result in a mutually recognized and mutually beneficial outcome, so that these two huge global markets can coordinate their regula-

tion and mutually accept the effectiveness of each other's regulation, so that the United States is not faced with a set of regulations that are foreign to its business or strange to its business, are not endogenous, and we can come to an agreement.

So we have embraced the services—the insurance sector has really embraced the U.S.–EU High-Level Working Group as a means to promote that very important dialogue with the Europeans.

Mr. HURT. Thank you, Mr. Vastine.

Mr. Kochenburger?

Mr. KOCHENBURGER. Thank you.

I think a couple of years ago—just one quick point to add—a couple of years ago, Director McRaith, when he was commissioner in Illinois, testified before Congress on behalf of the NAIC on Solvency II. And I think the term he used, which is one I like, is that it is not a cure-all, it is not a panacea, and it is not necessarily the model for the world.

And I think part of the concern would be that the United States solvency models have actually worked fairly—well, very effectively, and, also, that some of those models in the United States respond to very different situations that we have in the EU or elsewhere in the world, particularly in property casualty, where in property there may be a lot of similarities, but of course liability models in the United States are far different. Briefly put, you can be sued about many more things in the United States than in other countries and often for a long time. So, property casualty companies in the United States have had to be very concerned about not only asbestos claims, clerical abuse claims, and others that go back 20, 30, 40, or 50 years, but what will be the next level of asbestos claims.

Again, this responds to our own unique liability system. And that means that Solvency II and other models, whatever their merits, may, in fact, not necessarily be the best ones for here. And so, that is a concern I share.

Also, however, the importance of equivalence, of course, can't be overstated. Our companies absolutely—and they can say it much better than I can, and they have said it today—need the ability to be deemed equivalent in order to work within their second significant largest insurance market in the world.

Mr. HURT. Thank you, Mr. Kochenburger.

Mr. McRaith, would you like to respond?

Mr. McRAITH. The EU's Solvency II framework is a well-conceived framework adopted by some very smart insurance people who reside and operate and have worked in the EU. And we congratulate them on that initiative and on the development and progress they have made.

The purpose of the EU–U.S. insurance dialogue which I described earlier is to alleviate the concern, resolve the uncertainty for the insurance sector based in both jurisdictions, so that companies, whether based in Europe or the United States, can compete, as needed, in emerging economies around the world.

Whether this results in something called an equivalence assessment by the EU, we can't be sure. What I can tell you is that the United States, through the dialogue or the insurance project that is now being undertaken, will conclude this year with a path forward. And we will, in fact, embrace best practices, if there are best

practices to be embraced. If not, we are going to move forward, hopefully arm-in-arm with our colleagues from overseas.

Mr. HURT. Thank you.

Mr. McCarty, we are over time, but would you like to respond briefly?

Mr. MCCARTY. Yes, I concur with Director McRaith that we certainly commend our colleagues overseas for the great work they did to modernize their solvency system; that we are participating with the Director on the steering committee to look at—and I think it is absolutely essential that we have a mutual recognition in order to preserve transatlantic commerce and provide better choices and stability for our consumers.

Mr. HURT. Excellent. Thank you.

I want to thank each of you for joining us today and for providing your insight and comments to our committee.

I ask unanimous consent to insert the following material into the record: a May 17, 2012, statement from the American Insurance Association; a May 17, 2012, statement from the Council of Insurance Agents and Brokers; a May 17, 2012, statement from Property Casualty Insurers Association of America; a May 17, 2012, statement from the National Association of Mutual Insurance Companies; and a 2009 U.S. International Trade Commission report entitled, “Property and Casualty Insurance Services: Competitive Conditions in Foreign Markets.” Without objection, those documents will be admitted into the record.

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 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

With that, once again, I thank the members of the committee, and I thank the members of the panel for joining us. And this hearing is adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

A P P E N D I X

May 17, 2012

Rep. Dold Opening Statement

As we all know, our insurance industry is a large and critical component of our financial services industry and of our economy generally.

The insurance industry directly employs well over 2 million Americans with stable and well-paying private-sector jobs.

Our insurance industry is also the source of many billions of dollars of private-sector investment capital every year. These insurance-industry investments help other businesses start, expand, and create even more good, stable, and well-paying private-sector jobs in all kinds of other industries.

And, while directly and indirectly supporting so many private-sector jobs, our insurance industry provides many millions of policy-holders with peace of mind, security, and compensation in difficult, unfortunate, and sometimes very tragic circumstances.

Historically, an important component of the insurance industry's positive impact on our economy has been a largely predictable, reasonable, and successful domestic regulatory framework.

This regulatory framework is one important factor in the industry's ability to withstand many economic downturns, including the most recent recession, during which we suffered no significant insurance company failures from actual insurance operations.

One reason for the insurance industry's resilience has been that our policy-makers and regulators have always understood that the insurance industry is fundamentally different than the banking industry.

The two industries have very different business models, purposes, and risks, and so they must have different regulatory objectives and standards.

So, as we consider emerging proposals to coordinate international insurance regulations, we must avoid undermining our historically successful insurance industry regulatory framework, whether by improperly super-imposing banking industry regulations or otherwise.

We must also ensure that U.S. domiciled insurance companies are not placed at a competitive disadvantage in future international agreements and that we remove barriers to foreign insurance markets.

This will inevitably raise difficult questions about the interaction between federal and state regulations, the interaction of regulations among the different states, and how our domestic regulations and trade agreements compare to those of foreign nations in an inter-connected global marketplace.

In the end, our objective is help create the conditions that will maximize private-sector job growth, economic prosperity, and global competitiveness, while also ensuring that consumers are adequately protected and have access to a broad range of affordable insurance products.

Finally, I'd like to thank our witnesses for sharing their time, testimony, and experience, and I'd like to thank Chairwoman Biggert for holding this hearing and for her leadership on these very important issues.

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**Statement of the
Honorable Steve Bartlett
President and Chief Executive Officer
The Financial Services Roundtable
before the
Committee on Financial Services
Subcommittee on Insurance and Housing and Community Opportunity
U.S. House of Representatives
May 17, 2012**

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify on behalf of the Financial Services Roundtable (the Roundtable).

I am Steve Bartlett, the President and CEO of the Roundtable. The Roundtable is a national trade association composed of 100 of the nation's largest banking, securities and insurance firms. Our members provide a full range of financial products and services to consumers and businesses. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

Making the U.S. insurance sector more competitive at home and abroad is critical to sustaining our economic recovery. U.S. insurance companies create jobs in every congressional district; finance municipal, state, and federal investment; help small and large business mitigate risk; and support individuals and families when they most need assistance. Insurance is a part of every aspect of our economy. Without insurance, people could not drive cars or eat in restaurants, cities could not build bridges or highways, and companies could not build plants or create new jobs. Insurance is critical to our economy and the Roundtable is proud to represent 30 companies that provide this important service.

My testimony will highlight priorities that will materially impact the U.S. insurance sector's international competitiveness. These priorities include: the role of the Federal Insurance Office (FIO); the designation of Systemically Important Financial Institutions (SIFIs) and Global Systemically Important Financial Institutions (G-SIFIs); domestic regulations that hinder U.S. competitiveness; and expanding U.S. insurers access to markets throughout the globe.

Federal Insurance Office

First, we support a strong and effective Federal Insurance Office (FIO). To that end, we support an increase in the FIO's funding, staffing levels, and stature. The creation of the FIO, for the first time, places an office in the Department of Treasury to increase federal understanding of insurance matters and regulation. An important task before the FIO is identifying ways to improve and modernize the current domestic insurance regulatory system.

The FIO also has the mandate to represent our domestic sector internationally. We have long believed that a principal short-coming of the state-based regulatory regime is the constitutional inability of the individual states or the NAIC to bind our country. This can compromise the effective representation of the insurance industry internationally and preclude U.S. negotiators ability to speak to international regulators

with a unified voice. The FIO can make up for that short-coming by serving as our nation's voice in international forums. The FIO has the statutory mandate to fulfill this role, is a federal government entity, and possesses the consistent and steady institutional support to effectively engage in international forums. As the strong voice for the U.S. insurance industry, the FIO director can protect the industry from duplicative or contradictory regulations.

We are pleased that the FIO has joined the International Association of Insurance Supervisors (IAIS) and encourage its full participation to enhance the voice of U.S. insurance market participants internationally. Regulations being crafted abroad already have a significant impact on U.S. insurers in their operations both domestically and outside the U.S.

One important example is the European Union's Solvency II regime. Solvency II will stipulate the amount of capital insurance companies must hold against their risk exposure. The Solvency II requirements differ substantially from many of the individual State solvency requirements. Unless and until the U.S. regulatory system is deemed "equivalent" to the Solvency II system, U.S. insurers operating in Europe, as well as U.S. insurers that have a foreign parent subject to Solvency II will be required to comply with Solvency II rules. EU subsidiaries of US groups will also need to comply with Solvency II in such circumstances.

Internationally active insurer groups cannot continue to effectively manage their businesses if forced to meet differing regulatory standards. Compliance with diverging regulatory requirements decreases their efficiency, presents significant obstacles and creates an uneven playing field. To avoid this onerous result, it is critical that a period of "transitional equivalence" be permitted during which the U.S. and Solvency II countries can work toward jointly determined standards. During this period of transition, the FIO, in consultation with State regulators, must continue discussions with the European Commission to ensure that the State solvency system will ultimately be deemed equivalent to Solvency II. The FIO is to be commended for bringing various regulators together to agree on a work plan to assure that international accords are made in the best interests of the U.S. insurance market participants.

It is also important to note that the insurance business bears unique risks and should be regulated differently than other financial services sectors. This is an important consideration as the Common Framework for Supervision of Internationally Active Insurance Groups (ComFrame) initiates the interaction between supervisors to identify internationally active insurance groups and delegate roles and responsibilities of group-wide and host supervisors. These will be complex deliberations and decisions that require a strong, unified voice. The Roundtable supports the FIO's statutory authority to serve as that voice.

Systemically Important Financial Institutions

Second, it is critically important that global regulators' efforts to monitor and regulate systemic risk in international markets not be allowed to upset the carefully calibrated system that U.S. regulators have designed for domestic purposes. The Financial Stability Oversight Council (FSOC) has been charged with designating nonbank systemically important financial institutions (SIFIs) that will be subject to supervision by the Federal Reserve. After a long and deliberative public process, FSOC has finalized a three-stage methodology that screens companies early in the process, using publicly available data to filter out the majority of nonbank financial institutions from further consideration. This methodology is designed to ensure that only a small number of institutions are subject to enhanced Federal Reserve supervision.

Global regulators at the Financial Stability Board intent on designating so-called global systemically important financial institutions (G-SIFIs), would do well to follow the United States' lead and adopt a similar screening process, after adequate public consultation, that reserves the systemic label for only those international companies whose global reach presents risk to the world's financial system. Anything less has the potential to put U.S. insurance companies and other nonbanks at a competitive disadvantage and act as a further brake on an already weak economic recovery.

The FSB and FSOC, along with the IAIS, must undertake this coordination to prevent international financial institutions from facing redundant, and even worse, conflicting regulations. One concept would be to provide deference to the primary regulator of a consolidated group company with respect to regulation for systemic purposes. This would have the additional benefit of focusing scarce regulatory resources and making one entity responsible for the group company.

Finally, it is important that both the FSOC and FSB understand the unique risk characteristics of insurance companies, which are very different than the risks associated with banks and other financial institutions. We encourage the FIO to assist both bodies in making their judgments.

Domestic Regulatory Burdens

Third, in addition to the explicit international issues, it is also important to recognize that the domestic regulatory environment can hinder U.S. insurer's ability to compete internationally.

For example, the rulemaking process for the Volcker Rule has created unnecessary uncertainty concerning Congress's decision to preserve longstanding regulated insurance company investment activities. A U.S. insurer's ability to manage long-term liabilities through diverse allocation of investment assets is a key component

of its business model, but some have contemplated that the Volcker Rule might prevent U.S. insurance companies from investing in “covered funds.” Domestic insurers will be placed at a competitive disadvantage compared to international companies if this misinterpretation of the statute and Congressional intent is applied.

Also, as discussed earlier, the risks associated with insurance companies cannot be treated the same as the risks associated with banks. This distinction must be noted as domestic capital standards are implemented. Administering identical stress tests to insurance companies and bank holding companies confuses the risk profiles of the different businesses. This one-size-fits-all application fails to provide effective supervision and adversely affects U.S. insurance companies as they seek to compete in the increasingly competitive global environment.

Market Access

Fourth, we strongly support efforts to eliminate barriers to foreign insurance markets. This can best be accomplished by the United States engaging in trade matters impacting insurers through the FIO.

The United States Trade Representative (USTR) has effectively worked to expand U.S. access to foreign markets, completing in the past few years free trade agreements with Columbia, Korea, and Panama. We applaud Congress for passing the trade agreements. The terms are positive and will provide U.S. insurance companies the opportunity to access new, important markets. The Roundtable believes that the FIO’s participation in future trade dialogues will bring increased expertise to these discussions and will enhance the good work of the USTR.

In addition, the Administration should continue to engage China through its Strategic and Economic Dialogue (S&ED). Though progress has been at times frustratingly slow, it has produced some success. For example, earlier this year the Chinese government announced it would lift the prohibition on foreign firms offering mandatory auto insurance policies. This expands access to China’s \$50 billion auto market.

Through this same example of auto coverage, however, it is clear that much remains to be done to enhance the competitiveness of U.S. firms operating in China. In addition to the limitation on product offerings, a foreign firm attempting to sell auto insurance can only open one branch at a time. And opening a branch takes approximately 18 months. Such restrictions impede U.S. competitiveness and must be addressed.

On the life-side of the business, China has placed a moratorium on new licenses approvals for foreign firms offering retirement security products, including enterprise annuity and group annuity products. This moratorium has been in place since October

2008. There is a pending backlog of applications that should be acted on, and we encourage China to establish a first to market U.S. licensee. This is just one example of the obstructions that U.S. insurers face and that we ask Congress to work with the Administration to remedy.

Reform efforts should not, however, be limited to China. The U.S. government should engage with Latin American nations, India, and other countries to encourage open markets.

For instance, in December 2010, the Brazilian Ministry of Finance ordered the country's insurance regulator to promulgate new reinsurance regulations that dramatically restrict the ability of U.S. insurers and reinsurers to do business in this market. These actions reverse market liberalizing actions Brazil took in 2007 to demonomolize its reinsurance sector and, as a result, have severely restricted development of the country's insurance industry, undermined Brazil's ability to obtain reinsurance, restrained competition, and increased the cost of reinsurance for Brazilian companies.

Another example of barriers to entry of U.S. insurers in foreign markets is the limits imposed on investment by non-domestic insurers in other markets (the "FDI cap"). India opened up its insurance market to non-Indian insurers 12 years ago; however, foreign direct investment by insurers in the Indian insurance market is capped at 26%. Efforts to raise the 26% FDI cap to 49% have not proven successful.

The Roundtable encourages the administration to expand trade and access wherever possible. The progress being made by the eight other countries in the Trans-Pacific Partnership (TPP) is promising. And Congress should welcome additional bilateral and multi-lateral trade efforts to expand access to foreign markets.

Conclusion

In conclusion, Madame Chairwoman, I again commend the Subcommittee for examining the important topic of international competitiveness in the insurance sector. Both the industry and policymakers will face some critical tests in the near- and medium-term. Policymakers will be asked to craft appropriate domestic and international regulatory policies and expand U.S. access to growing markets. Companies will confront an increasingly competitive landscape in which the regulatory environment remains uncertain.

This hearing is an important step in meeting those challenges, and the Roundtable looks forward to working with the Committee in the months ahead to strengthen the international competitiveness of U.S. insurance companies.

**Subcommittee on Insurance, Housing
and Community Opportunity**

**Committee on Financial Services
United States House of Representatives**

Hearing on

U.S. Insurance Sector: International Competitiveness and Jobs

May 17, 2012

Testimony of

Peter Kochenburger
Executive Director, Insurance Law Center
Associate Clinical Professor of Law
at the
University of Connecticut School of Law

Good afternoon. My name is Peter Kochenburger and I am a professor at the University of Connecticut School of Law and the Executive Director of the School's Insurance Law Center. Thank you for the opportunity to appear today and to submit this written testimony.

A Clear Need for International Cooperation in Insurance Regulation

Insurance is both a global industry and one increasingly integrated within the broader financial services markets. These developments challenge traditional insurance regulatory systems which are based on sovereignty at the national or regional level, and frequently segregated from oversight of other financial services providers such as depository institutions. Fortunately, many governments have taken important steps to address these changes, including the creation of the International Association of Insurance Supervisors (1994), the European Union's "Single Market" and attempts to harmonize European insurance and financial services law, and within our country, the creation of the Federal Insurance Office (FIO), and the National Association of Insurance Commissioners' (NAIC) current focus on regulatory consistency and international cooperation. Individual states have also developed useful relationships with insurance regulatory authorities abroad, such as the recent Information Exchange Agreement reached by my home state of Connecticut and the IAIS.

Unquestionably international regulatory coordination is essential to maintaining the solvency of insurers and other financial institutions. Our insurers, reinsurers, agents and brokers also need fair access to markets outside the United States, and recent agreements in South Korea and China are very positive developments, as several speakers may discuss today. Similarly, our markets must be open to international competition, but they present unique challenges given our state-based regulatory structure. Congress, state regulators and the NAIC are familiar with the barriers historically presented by multiple reinsurance collateral requirements, licensing and filing procedures, solvency standards, and the need to work with state regulators who differ not only on the scope of their regulatory authority, but also on how to wield it.

We should also acknowledge many of the advantages of our country's state-based regulatory structure as well as the NAIC's accomplishments at modernizing insurance regulation nationally, and serving as a major voice for our country internationally. However, the federal government should clearly take the lead role in representing US regulatory interests internationally and negotiating insurance-related trade agreements. Individual states do not have the legal authority to negotiate on behalf of the U.S., nor the national perspective and mission which must necessarily fall to our federal government. While the NAIC plays an important role internationally and is the repository of significant experience and expertise, it is also a private organization not suited for concluding treaties abroad.

The FIO was established with this specific role in mind when it was created in 2010 and while still a work in progress, its mission is indispensable and cannot be undertaken by state-based or private entities. The FIO's statutory powers and limitations were carefully, and no doubt painfully, crafted to provide the FIO with the minimal powers necessary to represent U.S. interests internationally and to provide a participatory (rather than regulatory) voice related to domestic insurance regulation. The FIO's "Advance coordination" requirements (31 U.S.C. § 313(e) (4)), which limit the FIO's authority to even approach insurers with information requests, and its restricted subpoena power (31 U.S.C. § 313(e) (6)), should mean that insurers will receive few FIO regulatory requests for information, and even fewer subpoenas. FIO's statutory authority emphasizes communication and information sharing with state and federal regulatory agencies, which have clear incentives to cooperate with it.

Consumer Protection and International Cooperation

Regulatory modernization is not a code word for deregulation and international cooperation should not be an opportunity or rationale to dilute consumer protection standards in the United States. While insurance regulation in the U.S. has significant gaps, we also have a tradition of consumer protection at the state (and sometimes federal) level more rigorous than found in many other countries. As international cooperation

increases, some will likely pick and choose among regulatory provisions in other countries to argue that those that are least restrictive are also the most appropriate and should be imported to the U.S., while also ignoring more protective regulatory regimes. Healthy industry self-interest makes this selection process predictable, but it should not be condoned by legislators and regulators.

Consumer protection standards are rooted within specific legal and regulatory structures and responsive to local (i.e., national and regional) conditions. These differences include common law versus civil law legal systems, political philosophies about the role of the state and public regulation of private sector transactions, and the use of private litigation in enforcing consumer rights. This is historically true in insurance, which has been considered a matter of “local” (i.e. state) concern and treated differently than other financial products.

For example, in our country personal lines rate and form regulation are long-used and important regulatory tools and should not be weakened or jettisoned because some foreign jurisdictions do not employ them.¹ Courts and legislatures in the US have recognized for decades that a classic freedom of contract approach is often an inappropriate regulatory standard when applied to modern adhesion contracts like insurance policies, and have adopted a variety of measures and standards which, if not leveling the playing field, at least have reduced its tilt. In addition to regulatory review, these methods include common-law doctrines such as the duty of good faith and fair dealing and enhanced “bad faith” damages applied to insurer conduct, and allowing consumers to recover attorneys’ fees when successful in litigation against a commercial party (as is common in many federal and state civil rights and consumer statutes). State consumer protection statutes also empower regulatory authorities and private parties to

¹ For example, EU countries may not employ rate regulation, though member states may regulate policy forms if in the “public good.” Third non-life Council Directive 92/49/EEC, articles 27-31, 39; for life insurance, Directive 2002/83/EC, article 34. In contrast, China is experimenting with both rate and form regulation. CIRC Ordinance No. 2004-6: Administrative Measures on Examination, Approval and Filing of Personal Insurance Products, <http://www.circ.gov.cn/web/site45/tab2727i38782.htm>.

investigate and remedy unfair or deceptive practices, though their application to insurance transactions varies by state.

In some areas the FIO can promote the value of our consumer protection tools, such as regulatory authority to review whether insurance policies are not only clear and transparent, but also fair, and the ability for private parties to enforce their own legal rights and not leaving to over-burdened and under-resourced regulators the sole responsibility for investigating and challenging insurer behavior. At a minimum, changes in traditional consumer protection standards, such as further reducing rate and form regulation (as advocated by many insurers and which previous Optional Federal Charter legislative drafts would have largely accomplished), should come from a domestic review of insurance markets and an appreciation of where these standards fit within the overall regulatory scheme, and not in the guise of international comity.

State Insurance Regulation as a Regulatory Obstacle?

The United States is unique in regulating insurance on a state rather than national level. The reasons for state-based insurance regulation are historical, political and practical. When insurance first became regulated in the US around the mid nineteenth hundreds,² the federal government's overall regulatory responsibilities were still minimal and insurance was considered an issue of local concern. The Supreme Court protected state regulatory control in *Paul v. Virginia* where it determined that insurance was not interstate commerce and thus could not be regulated by the federal government.³ The Court reaffirmed *Paul* over the next six decades until 1944 when it came to a different conclusion in *U.S. v. South-Eastern Underwriters Association*, ruling that the insurance business was sufficiently inter-state in character to permit federal regulation.⁴ Congress responded quickly, upon the urging of the NAIC, state regulators, agents and insurers, and in 1945 passed the McCarran- Ferguson Act, 15 U.S.C. 1011, which grants insurers limited immunity to federal antitrust laws and more significantly, reconfirmed an explicit

² The New York Insurance Department was established in 1860.

³ 75 U.S. 168 (1868).

⁴ 322 U.S. 533 (1944).

preference for state insurance regulation. Congress of course can still regulate the business of insurance simply by making its intent clear and McCarran-Ferguson, whatever its drawbacks, is not an obstacle to an increased federal role. However, outside of several discrete areas, and now health insurance, Congress has left insurance regulation to the states. The FIO's regulatory authority – as opposed to its information gathering function – is largely limited to preempting discriminatory state laws inconsistent with international treaties related to solvency regulation. It has yet to use this authority.

That insurance regulation is still state-based tells us little about the effectiveness of our system. While we would be highly unlikely to create a state-based regulatory structure for insurance if we were writing on a blank slate today, it has worked surprisingly well in some areas, especially in maintaining insurer solvency. For example, while the 2008 economic crisis can be attributed to many causes, the failure of federal regulatory agencies to police their industries is an important one. In contrast, the insurance industry was the one solvent and dependable financial services sector in 2008 and beyond. It was also the only one whose solvency was regulated largely by state rather than federal agencies. While the federal government should play a lead role in international regulatory issues, we do not have a reassuring model for either dual (“optional”) or exclusive federal regulation of financial services.

Undeniably state insurance regulation creates delays and duplication of effort by both the insurance industry and insurance regulators. However, we have a Constitutional structure that acknowledges significant state regulatory authority and federalism necessarily assumes a certain degree of duplication and inefficiency. The question is whether these costs are worth the benefits, not whether their existence is an excuse by itself to reduce state regulatory control. Regulatory modernization should not become a pretext for eliminating significant state regulatory authority and diluting vital consumer protection laws. At a minimum, we should allow the FIO time to assert its role internationally and reduce regulatory obstacles created by our state-based system, before we attempt significant changes in our own domestic regulatory structure.

The Need to Regulate Insurance

While the form of insurance regulation can differ significantly from country to country, they all attempt to address the same basic concerns. A private sector economy depends on a competitive and fair private insurance market. Insurance is a product that consumers, whether individuals or businesses, legally or practically must obtain to safeguard their assets and to engage in activities central to a market economy – driving, purchasing a residence, owning and operating a business or practicing a profession. Insurance is also a contract where the policyholder’s premium is consideration for the insurer’s promise to pay a covered claim that may occur years in the future and where the amount of the claim is likely to be much greater than the premium collected. Once the premium is paid, the policyholder becomes dependent on the insurer’s ongoing ability and willingness to pay the claim should an insured loss occur, as it cannot contract with another insurer to cover a known loss.

Insurance policies are also standard form agreements drafted exclusively by the insurer and for which there is little or no bargaining over terms other than price.⁵ The lengthy and complex structure of such contracts virtually makes certain that the great majority of consumers will neither read nor necessarily understand them. Policyholders often only become aware of important terms and limitations in their contract when an insurer denies a claim, which is also the time of their greatest vulnerability.⁶

These contractual arrangements usually benefit the contracting parties and society as a whole, but ensuring that they do, and that the insurance policies are fairly written and

⁵ As stated by the Pennsylvania Supreme Court: “The rationale underlying the strict contractual approach reflected in our past decisions is that courts should not presume to interfere with the freedom of private contracts and redraft insurance policy provisions where the intent of the parties is expressed by clear and unambiguous language. We are of the opinion, however, that this argument, based on the view that insurance policies are private contracts in the traditional sense, is no longer persuasive. Such a position fails to recognize the true nature of the relationship between insurance companies and their insureds. An insurance contract is not a negotiated agreement; rather its conditions are by and large dictated by the insurance company to the insured. The only aspect of the contract over which the insured can ‘bargain’ is the monetary amount of coverage.” *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 196 (Pa. 1977). This description is even more applicable in 2012.

⁶ In most instances, policyholders can only review their actual insurance contract after purchasing the policy, a situation contrary to basic concepts of contract law.

applied, must be achieved through regulatory oversight as well as market competition. The central features of the insurance relationship provide unique challenges to government regulators in ensuring that policyholders obtain their benefit of the insurance bargain. The primary focus in evaluating insurance regulation, whether internationally or domestically, should not be just on market efficiency, but on its effectiveness in meeting these goals and protecting policyholders and our national economy.

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Insurance, Housing and
Community Opportunity
Committee on Financial Services
United States House of Representatives

Regarding:

U.S. Insurance Sector: International Competitiveness and Jobs

May 17, 2012

Kevin M. McCarty
Commissioner, Florida Office of Insurance Regulation
and
President of the National Association of Insurance Commissioners

Introduction

Chairman Biggert, Ranking Member Gutierrez, and members of the Subcommittee, thank you for the opportunity to testify today. My name is Kevin McCarty, and I am the Commissioner of Insurance for the State of Florida. I am here as President of the National Association of Insurance Commissioners (NAIC), and I present this testimony on behalf of that organization. The NAIC is the United States standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, we establish standards and best practices, conduct peer review, and coordinate our 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.

Insurance markets have evolved over the years to become increasingly global, interconnected, and convergent – a trend that will undoubtedly continue in years to come. Insurance regulators are heavily invested in the future of insurance globally, and the NAIC is committed to coordinating with our regulator colleagues, both domestically and internationally, to ensure open, competitive, stable markets around the world. In this regard, the most important thing we can do is to promote a level playing field across the globe through strong regulatory systems while recognizing that there will continue to be different cultural, legal, and operational differences in regulatory regimes around the world. Our state-based system in the U.S. has a strong track record of evolving to meet the challenges posed by dynamic markets, and we continue to believe that well-regulated markets both here and abroad make for well-protected policyholders.

Today, I will provide the Committee with an overview of the NAIC's involvement in recent international discussions and key international regulatory developments that promote well-regulated markets abroad and protect policyholder interests. Specifically, I would like to focus my comments on three major areas: 1) international regulatory standard-setting, 2) trade and economic development, and 3) enhancement of coordination and communication among international insurance regulators.

International Regulatory Standard-Setting

Insurance is critical to the U.S. economy and plays an equally important role in global markets. The United States is the world's largest national insurance market, with more than one-third of the total global market share. In fact, the U.S. had more insurance business written within its borders than countries ranked 2 to 6 combined in 2010, and many of our states are home to more insurance activity than most countries around the world. Six of our states rank in the top 20 leading markets in direct written premium alone.

Our market leadership, however, is not based only on market share or premium dollar amount. We believe U.S. state insurance regulators provide leadership in the international regulatory community by setting strong standards, developing creative solutions to new and existing regulatory challenges, and consistently seeking to increase transparency and understanding in our efforts to protect policyholders' interests.

In this regard, we are pleased to work hand in hand with the Federal Insurance Office (FIO) in many of these international initiatives. FIO has an important role to play as a representative of the federal government in such discussions, and we are working hard to build a constructive partnership. While we expect the FIO to increase its level of engagement with the international regulatory community, the fact remains that state regulators have ultimate responsibility for implementing any new international standards. It is therefore critical that any international discussions and agreements relating to regulatory prerogatives continue to be made with the full participation and agreement of U.S. insurance regulators.

IAIS Initiatives

The NAIC was a founding member of the International Association of Insurance Supervisors, the IAIS, for short. Established in 1994, the IAIS has a membership that includes insurance regulators and supervisors from over 190 jurisdictions in 140 countries. Additionally, more than 120 organizations and individuals participate to some degree in the activities of the IAIS as Observers.

The IAIS is led by an Executive Committee, which has three representatives from the United States, including Dr. Terri Vaughan, the NAIC's Chief Executive Officer, Michael McRaith, the

Director of the FIO, and myself as President of the NAIC. Additionally, U.S. insurance regulators and NAIC staff are active participants in almost all of the twenty working parties of the IAIS, serving as the Chair of the Solvency Subcommittee, and the Vice Chairs of three other working parties: the Financial Stability Committee, the Supervisory Forum, and the Standards Observance Subcommittee. Our active participation and leadership roles in these various working parties continues to ensure that the national system of state-based insurance regulation in the U.S. has a prominent voice in the international arena as we discuss global insurance principles and standards.

The NAIC is devoting significant resources and energy to international standard setting through involvement at the IAIS and other international bodies such as the Organization for Economic Cooperation and Development (OECD). We were integral to the development of updated IAIS Insurance Core Principles (ICPs), approved last October, which provides the basis for the International Monetary Fund's insurance sector assessment in their Financial Sector Assessment Program (FSAP). The FSAP is designed to assess a particular jurisdiction's regulation of financial institutions. The last time the IMF assessed U.S. insurance regulation was in 2010, when the FSAP found that U.S. insurance regulators observed or largely observed 25 of the 28 IAIS ICPs. The IMF stated about the U.S. system: "There is generally a high level of observance of the Insurance Core Principles. Aspects of regulatory work such as data collection and analysis in relation to individual insurance companies are world leading. There are mechanisms to ensure individual states implement solvency requirements effectively."

The NAIC and state regulators are also active at the IAIS Financial Stability Committee, which is currently in the process of developing a methodology for identifying Globally Systemic Important Insurers (or G-SIFIs) at the request of the Financial Stability Board (FSB). As members of this Committee and with the NAIC as vice-chair, U.S. insurance regulators along with the FIO have extensive input into the ongoing IAIS process as the IAIS Financial Stability Committee works on this important issue.

In addition to participating and often leading these IAIS efforts, we especially look forward to hosting the IAIS annual conference here in Washington, DC, this October.

Joint Forum

The NAIC is also very active in the Joint Forum. Established in 1996 under the Basel Committee on Banking supervision, the International Organization of Securities Commissions, and the IAIS, the forum strives to deal with issues common to the banking, securities, and insurance sectors, including the regulation of financial conglomerates. The chairmanship of the Joint Forum rotates every two years among the standard setting bodies and in 2012, NAIC CEO Dr. Vaughan, was appointed Chair of the Joint Forum on behalf of the IAIS. Dr. Vaughan and her colleagues are focusing their efforts on enhanced communication between regulators, developing guidance and principles to encourage cross-sector consistency and reduce opportunities for arbitrage, and identifying duplication in work efforts. Current work of the Joint Forum includes studies on the cross-sectoral interactions of mortgage insurance, emerging longevity risk, and point-of-sale disclosures to consumers.

Financial Stability Board

The recent financial crisis has clearly demonstrated that it is not sufficient to focus on a single sector any longer, and we are increasingly being asked to participate in global dialogues with international supervisors and standard setters from across the financial spectrum. The FSB coordinates at the international level the work of international standard setting bodies and national financial authorities to address vulnerabilities affecting the global financial system and to develop and promote the implementation of effective supervisory and regulatory policies promoting financial stability.

The U.S., represented by the United States Treasury Department, Federal Reserve Board of Governors, and the Securities and Exchange Commission, is a member of the FSB, which is engaging directly with the IAIS on critical issues including the identification of G-SIFIs. The involvement of insurance regulators is essential as the FSB tends to have a bank-centric focus, but its decisions have an impact beyond the banking sector. Through the IAIS, we continue to stress that the insurance business model needs to be distinguished from the banking business model when discussing and applying any new regulatory requirements.

U.S. insurance regulators also continue to provide input to the FSB on systemic risk to ensure that the insurance sector perspective is appropriately represented at the FSB and that the FSB takes into account the differences among business models when promulgating any recommendations regarding the identification and appropriate regulation of non-bank SIFIs. I would encourage federal regulators and legislators alike to be mindful of both the scope and speed of the FSB's activity, and work to ensure that appropriate deference be provided to the regulatory authorities of member nations.

Economic Development and Trade

Next, I would like to focus on the insurance sector's critical role in promoting economic growth. In order to ensure that growth, we must maintain a level playing field here and abroad in order to create and protect jobs. There are a number of ways we as U.S. regulators are encouraging economic growth of the insurance sector for U.S. based insurers. We continue to promote a global regulatory approach based on fundamental, collective principles of solvency and consumer protection. We also continue to promote transparency and due process in international standard setting, which are critical to consumer confidence in insurance products, and should be primary considerations reflected in any recommended international standards.

State regulators are also keenly aware of the importance of international trade and trade agreements for economic development. As the Office of the United States Trade Representative (USTR) negotiates trade agreements such as the ongoing Trans-Pacific Partnership agreement and seeks improved market access for U.S. insurers, the NAIC provides technical expertise and advice. Our partnership with the USTR dates back to the early 1990s at a time when the North American Free Trade Agreement and World Trade Organization's – General Agreement on Trade in Services (GATS) were negotiated.

In providing expert regulator guidance to the USTR on technical provisions relating to insurance, state insurance regulators and the NAIC seek to ensure that agreements and policies under discussion will promote stable regulatory practices in other countries. We help our negotiators make the case that a liberalized market does not mean the weakening of regulatory standards by illustrating the openness of the U.S. market to foreign competition (over 20% of the U.S. insurance market is foreign controlled), yet we maintain an effective supervision of the market

place. We also illustrate to our trading partners the importance of insurance to our State economies and show the number of jobs the insurance sector supports back home and how insurance increases economic output. Furthermore, we discuss the role insurance plays in social policy through mitigating risk and protecting our citizens from the potentially devastating financial losses from floods or other natural disasters. The NAIC also plays a role in ensuring that the commitments that the U.S. undertakes in these agreements is consistent with existing State laws, and where necessary consult with the relevant States to effect changes that can eliminate unnecessary “reservations” to U.S. trade commitments.

In addition to such negotiations, the U.S. and a number of our trading partners hold annual insurance dialogues organized by the USTR, including China, Japan and recently Korea as part of their entry into force of the U.S.-Korea Free Trade Agreement. The NAIC serves as the representative for the regulators and participates in each of these dialogues, working side by side with our trade negotiators and providing guidance as they work to overcome remaining trade barriers. Ultimately, our role as technical advisors is to illustrate the benefits that our consumers have reaped from our open markets and also to ensure that USTR has the best technical advice on hand as they seek commitments from our trading partners during negotiations.

Through the NAIC's International Insurance Relations (G) Committee we provide technical assistance to developing economies. Over the years we have developed memoranda of understanding with 13 foreign countries to provide this assistance and regulatory cooperation. Often at the request of these foreign regulators, we regularly send U.S. insurance regulators and NAIC staff to provide the technical training that these countries need. The goal of these pro-bono projects is to aid these countries as they develop their insurance markets into stable and vibrant markets where U.S. insurers may ultimately be able to provide services. We also seek to partner with multilateral development banks such as the World Bank and the Asia Development Bank to provide the training.

Last, the NAIC is represented on the Organization for Economic Cooperation and Development's (OECD) Insurance and Private Pensions Committee by Pennsylvania Insurance Commissioner Michael Consedine. In that capacity, Commissioner Consedine attends OECD Committee and Subcommittee meetings and serves as the U.S. regulator expert on insurance, while sitting side by side with the Commerce & Treasury Departments. The NAIC drafts and

comments on insurance related papers, acts as the coordinating body in the completion of statistical questionnaires, and presents information about the U.S. system of insurance regulation.

Enhancing Communication and Coordination Among Regulators

Another area of focus I want to raise with you today is the importance of our improved information exchange and better coordination with our international regulatory counterparts. Through the NAIC we are redoubling efforts to strengthen supervision through enhanced coordination and better communication between regulators. State insurance supervisors are frequently involved in technical exchanges, training programs, and other forms of regular dialogue.

Our International Insurance Relations (G) Committee and International Regulatory Cooperation Working Group are tasked with strengthening international regulatory systems by interacting with international regulators, reviewing proposed laws and regulations for insurance supervisors in countries updating their regulatory structure and those with emerging economies, conducting educational seminars to provide an understanding of the U.S. system of regulation, and establishing fellowship opportunities between U.S. and foreign insurance regulators, among other things. The NAIC also launched its own Solvency Modernization Initiative (SMI) in 2008 as part of our continuous improvement process. As part of that initiative, we are examining international developments regarding insurance supervision, banking supervision, and international accounting standards, and will consider potential applications for U.S. insurance regulation.

ComFrame and Supervisory Forum

One key initiative NAIC members and staff are working on is the development of a Common Framework or “ComFrame” for the Supervision of Internationally Active Insurance Groups, or IAIGs. This project, conducted through the IAIS, aims to make group-wide supervision of IAIGs more effective, foster cooperation and coordination among supervisors around the world and to close regulatory gaps. The ultimate role of ComFrame is still under discussion and will continue to develop; however, the intent is given by its name – a common framework – one that lays out how supervisors around the globe can work together to supervise internationally active insurance groups. ComFrame should not be an additional layer of prescriptive requirements, but rather a

framework that regulators from around the globe can use to effectively supervise large global firms, despite the differences that will remain between each of our respective regulatory systems. If done right, ComFrame has the potential to create a multi-jurisdictional approach to supervision that emphasizes robust oversight and cooperation while maintaining the proper balance between different jurisdictions.

U.S. regulators are also actively involved in the development of the Supervisory Forum at the IAIS. That Forum aims to strengthen the effectiveness of insurance supervision and to foster convergence of supervisory practices through the exchange of real-world experiences and the expertise of front-line, senior regulators from around the globe. The concept of the Forum stemmed from a U.S. proposal based on the U.S. multi-jurisdictional approach, utilizing discussions similar to those that occur at the NAIC's Financial Analysis Working Group (FAWG).

US-EU Dialogue

Another critical area in the international insurance regulatory arena that continues to grow in importance is the work done to harmonize regulatory approaches and foster regulator trust and mutual understanding. We must remember that the focus of regulatory convergence should be the arrival at common outcomes, and not necessarily universal requirements or structures. As we continue to work with our international counterparts, U.S. regulators cannot abdicate our responsibility to consider the impact of regulatory convergence on U.S. insurance consumers and companies. We have an obligation to engage with our foreign counterparts, along with the FIO and USTR, to ensure that differences in regulation between jurisdictions do not become an unnecessary barrier to transatlantic trade, while preserving the elements of our system that provide a stable and competitive market.

A prime example of our work in this area is the NAIC-EU regulatory dialogue. The NAIC has had ongoing dialogues with the EU for over 10 years on various topical issues of mutual regulatory concern. These recurring dialogues have been critical to enhancing supervisory understanding, cooperation and coordination between our respective jurisdictions and have established the basis on which to build new cooperation projects. A new US-EU joint project, led by a steering committee of key U.S. and EU government representatives, is guiding the

priorities of 7 technical work streams to identify areas of alignment and differences between the two regulatory systems. The U.S. representatives to this steering committee are myself, NAIC CEO Dr. Terri Vaughan, and the Director of the Federal Insurance Office, Michael McRaith. Each of the technical work streams have representatives from the States, NAIC, FIO and the EU, and we believe this process provides us with an opportunity to work collaboratively with our EU counterparts and FIO in a constructive manner to develop an even better mutual understanding of our respective systems. Through these processes, regulators develop a trust in our respective systems while laying the groundwork for increasing convergence in the future, consistent with the IAIS standards. We continue to demonstrate that the U.S. has a strong system of insurance solvency supervision that helped the world's largest insurance market weather the worst financial crisis in decades.

Just last month, several U.S. regulators and I participated in a week of US-EU events including an NAIC-EU regulator-to-regulator dialogue in Washington. Topics we discussed included international standards development including ComFrame, supervisory cooperation, and issues of mutual concern related to global financial stability. We also discussed domestic regulatory developments and market trends in our respective jurisdictions. As I noted, these kinds of exchanges and dialogues are critical to successfully improving insurance regulation everywhere. Other issues that we continually discuss with our colleagues from Europe and around the world include best practices, transparency and due process, cross-border insurance services, and regulatory harmonization. The more robust dialogue and mutual understanding we can create, the better our regulatory communities will be equipped to face challenges that arise.

International Fellows Program

Building on the success of our China Intern-Pilot Program in 2004, the NAIC developed a formal International Internship Program in 2005 to advance working relations with foreign markets, emphasizing the exchange of regulatory techniques and technology. The program was formally renamed the International Fellows Program in 2010. The Fellows participate in a week-long orientation program at NAIC offices in Kansas City, Missouri, focusing on the broad principles of insurance regulation in the United States. Each Fellow then travels to a different state for five weeks, working in technical areas of their specialization under the supervision of a state

insurance department staff member, who serves as a mentor and host. Over 168 fellows from around the globe have participated in this training program since its inception in 2004.

Conclusion

In light of the 2008 global financial crisis and subsequent developments, the insurer business model is evolving. We at the NAIC, along with our fellow regulators around the world, must also evolve and improve the way we supervise our markets. We must continue our ongoing efforts to develop better structures and tools to help us anticipate risk, some of which may evolve beyond our borders.

Beyond all the formal structures and tools we discuss today, increased regulatory collaboration ultimately hinges on fostering trust and relationships between supervisors in order to ensure we will all be successful in the very challenging tasks we face. As I mentioned earlier, well-regulated markets and competitive markets are not mutually exclusive, and both are necessary to provide policyholders with the choice and stability they expect from their insurers. At the NAIC we will continue to coordinate with FIO, the USTR, industry, and our international colleagues to develop the types of regulatory schemes that promote **open, competitive, stable, and well-regulated markets around the world**. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions today.

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Statement of Michael T. McRaith
Director, Federal Insurance Office
U.S. Department of the Treasury
Hearing entitled "U.S. Insurance Sector: International
Competitiveness and Jobs"
Before the Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives

May 17, 2012

Chairman Biggert, Ranking Member Gutierrez, Members of the Subcommittee, thank you for inviting me to testify today regarding the international issues affecting the ability of U.S.-domiciled insurance and reinsurance companies to compete globally and create jobs.

My name is Michael McRaith, and I am the Director of the Federal Insurance Office (FIO).

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) established the FIO and gave it broad authority, including "to coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors (or a successor entity)[IAIS], and assisting the Secretary in negotiating covered agreements[.]"

Until the establishment of FIO, the United States was not represented by a single, unified federal voice in the development of international insurance supervisory standards. I am pleased to report that FIO is a growing international presence on matters affecting the U.S. insurance sector, and we will further increase our global activities in the coming months. I am grateful for this opportunity to highlight some of our initial accomplishments.

In recognition of interest expressed by members of this Committee and others, FIO greatly benefits from the support of Secretary Geithner and leadership of Treasury. While our staff is not yet complete, we will be adding four new employees in May and expect to build to a staff of approximately 15 professionals.

The FIO study and report on how to modernize and improve the system of insurance regulation in the United States has not been released. I recognize the high level of interest in this report and appreciate the patience and understanding of this Committee. Once released, we trust you will find the report to be of appropriate depth and quality.

FIO also benefits from our experienced and skilled colleagues in Treasury's International Affairs (IA) division. FIO depends upon the IA team's expertise, and appreciates Treasury's integrated and collaborative support of FIO's development.

Although FIO has myriad responsibilities, including providing insurance sector expertise to the Financial Stability Oversight Council (Council), FIO's immediate predominant focus is on

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international issues, involving key bilateral relationships and critical international initiatives that I will discuss later in more depth. FIO provides the United States with a sophisticated, experienced and authoritative voice on international insurance matters. Given the current fast-paced development of international insurance supervisory standards, and the explosive growth of premium volume in emerging markets, FIO's participation and engagement arrives at an opportune moment for U.S.-based insurance consumers and industry.

Insurance markets are increasingly global. The growing global market implies huge growth opportunities for the U.S. industry, and underscores the increased importance of FIO participation in international fora to secure sufficiently robust international standards. Insurers are generating more revenue from outside the home jurisdiction than ever before, and that trend appears to be increasing dramatically. Excluding health insurance, the United States constitutes more than 27 percent of global premium volume, an enormous concentration of revenue for internationally-active insurance groups. However, the development of middle classes and the increased market sophistication in many emerging economies emphasize the importance of appropriate international regulatory standards to serve as a platform for U.S.-based insurers to participate in non-U.S. markets.

The U.S. insurance marketplace is, itself, growing more international. The Reinsurance Association of America published a study in 2011 that reported 60 percent of the U.S. reinsurance market was ceded to non-U.S. reinsurers. A recent McKinsey study showed that insurers, including U.S.-based insurers, are far more global today than even 5 or 10 years ago, now generating almost 33 percent of premium volume from outside the insurers' home countries. The exact percentage varies by company and country, of course, with European-based insurers collecting as much as 65 percent of revenue from outside the home countries.

For purposes of developing federal policy on international insurance matters, FIO intends to work closely and consult with state insurance regulators and other federal agencies. The states remain the primary regulators of the insurance sector in the United States – FIO's creation and development do not alter the locus of insurance regulation. My friends and former colleagues at the state level are talented, hard-working, and are supported in every state by career regulators who are skilled and dedicated public servants. Consultation with state insurance regulators will remain an essential component of FIO's international policy development process.

On a personal and professional note, I recognize and appreciate the leadership of Florida Commissioner Kevin McCarty, with whom I testify today. Commissioner McCarty has ably represented state regulators in international matters for several years, and I look forward to continued engagement with him and his colleagues on the important international matters that form the basis for today's hearing.

Nevertheless, whether we support state-based or federal insurance regulation, we must consider best practices which are evolving globally. The U.S. economy and consumers benefit from fact-based appraisals of best regulatory practices developed elsewhere, even if those practices deviate from practices historically employed by state-based regulators.

Europe

The European Union (EU), the European Parliament and the European Commission (EC), and the European Insurance and Occupational Pension Authority (EIOPA), are modernizing the EU's insurance regulatory regime through the Solvency II Framework Directive. First adopted in 2007, Solvency II is now scheduled for implementation in 2014.

Solvency II reflects the collective effort of experienced insurance supervisors and professionals who designed the framework to foster financial stability and support the collective interests of the EU-wide insurance market. The EC and EIOPA employ some of the most capable insurance professionals in the world, and the world outside the EU can benefit from studying and understanding the Solvency II approach to insurance supervision.

One aspect of Solvency II requires the EC to determine whether non-EU regulatory systems provide a similar level of solvency protection to policyholders as does Solvency II and, therefore, whether that system is "equivalent." Insurers based in an "equivalent" jurisdiction will be able to access the EU market without additional supervisory expectations, such as additional capital requirements.

Working with representatives of the EC, EIOPA and the Financial Services Authority of the United Kingdom (FSA), as well as with representatives of the state insurance regulators, FIO is engaged in a mutual assessment of the U.S. and EU insurance regulatory systems. The objective is to compare the design and efficiency of the respective supervisory regimes in order to promote consumer protection, business opportunity and effective regulation.

As an alternative to either or both jurisdictions entering into unilateral equivalence exercises, FIO initiated an EU – U.S. insurance dialogue (Dialogue) because the insurance industry based on both sides of the Atlantic needs greater clarity and certainty as to regulatory expectations and capital requirements. We commend our partners from the EC, EIOPA, the FSA, as well as the state regulators, in this constructive and good faith engagement. In two meetings hosted at Treasury, another meeting held in Basel, Switzerland, and on several telephone calls, all six members of the leadership team, or the Steering Committee, have committed to bring these discussions to conclusion by December 2012.

Technical committees comprised of experts from both the EU and the United States are evaluating seven critical substantive areas:

- Group supervision;
- Capital and use of internal models;
- Reinsurance, including collateral;
- Professional secrecy/ confidentiality;
- Financial reporting, data collection and analysis;
- Supervisory peer reviews; and,
- Independent audits, actuarial reports and on-site regulatory examinations.

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The technical committees will prepare written, factual assessments explaining how the supervisory regimes of both jurisdictions address each of these seven areas. This will allow the Steering Committee to evaluate similarities and differences in the two systems. The Steering Committee is committed to allowing ample participation by interested parties, including release of the assessments for public review and comment. These assessments can inform the final phase of the Dialogue in which the Steering Committee members will determine the regulatory areas for which increased convergence can be expected, the areas for which enhanced understanding will be the goal, and those areas for which convergence or harmonization will not be immediately contemplated.

For several years, interaction between the insurance regulators in both jurisdictions has not been constructive. With due regard to business development opportunities around the world, FIO will bring the EU – U.S. insurance Dialogue to a timely conclusion to allow insurers based in either the EU or the U.S. to compete fairly in any jurisdiction and with the clarity needed to plan strategically over the long term.

International Association of Insurance Supervisors (IAIS)

As stated above, the Dodd-Frank Act authorizes FIO to represent the United States at the IAIS, establishing for the first time an office within the U.S. government to participate in and represent the collective interests of the United States on international prudential insurance matters. FIO became a full member of the IAIS on October 1, 2011, and joined the IAIS Executive Committee on February 24, 2012.

The IAIS, which includes insurance supervisors and regulators from 140 countries, has two primary objectives:

1. To promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and
2. To contribute to global financial stability.

IAIS – Financial Stability Committee

The G-20 Leaders, at the Seoul Summit in November 2010, endorsed a policy framework developed by the Financial Stability Board (FSB) to address the moral hazard posed by systemically important financial institutions. Last November, at the Cannes Summit, the Leaders requested extension of the FSB's policy framework to nonbanks of global systemic importance. The IAIS, in cooperation with the Financial Stability Board (FSB), is developing the methodology and indicators to identify global systemically important insurers (GSIIs). The IAIS Executive Committee assigned this important task to its Financial Stability Committee (FSC), and FIO has participated in the FSC's work since July 2011. FIO has developed solid working relationships with our counterparts on the FSC, and is working to ensure this process will align with the criteria, methodology and timing of the Council's process for designating systemically important nonbank financial institutions. The FSC, led by Chairman Yasuhiro Hayasaki of the Japan Financial Services Authority, is doing sophisticated and thoughtful work. We expect the

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IAIS will soon release a paper describing its draft criteria and methodology for public consultation. Under current plans, the IAIS plans to finalize the criteria and methodology in November, and use this methodology to produce, early in the second quarter of 2013, an initial list of insurers considered of global systemic importance. This timeline, slower than originally envisioned, which has been approved by the FSB Steering Committee, allows more time for thoughtful and considered development by IAIS experts, and aligns with plans applicable to the Council process.

IAIS – Common Framework for the Supervision of Internationally Active Insurance Groups

FIO is increasingly engaged in the IAIS effort to develop a common framework, or “ComFrame,” for the supervision of internationally active insurance groups. The objectives of ComFrame are to:

1. Develop methods of operating group-wide supervision of internationally active insurance groups;
2. Establish a comprehensive framework for supervisors to address group-wide activities and risks and also set grounds for better supervisory cooperation; and,
3. Foster global convergence of supervisory approaches and measures.

ComFrame confronts the difficult task of establishing a common translation of different regulatory systems that, among other things, evaluate capital adequacy differently, employ unique accounting approaches, evaluate and weigh risks differently, and/or utilize varied approaches to regulation of insurers’ investments. These differences often render the work of the ComFrame subcommittees complex and challenging. While recognizing these hurdles, FIO supports the objectives of the ComFrame initiative as critical to the increasingly global nature of insurance markets across jurisdictions.

FIO supports the ComFrame objectives as developed under the leadership of Monica Machler, Vice Chair of the Board of Directors of FINMA, Switzerland’s financial regulatory authority. FIO has been involved with and followed ComFrame since October 2011, and is increasingly engaged with the technical aspects of its development. FIO will continue to provide support to the subcommittees providing technical input for the ComFrame initiative. FIO looks forward to coordinating with state insurance regulators and interested parties as we develop the policy of the United States on this important initiative.

Organization for Economic Cooperation and Development (OECD)

The OECD is another multilateral organization in which FIO is working to advance U.S. objectives. The OECD’s current work on insurance includes considering how to manage large-scale disasters, including terrorism risks, and how to establish alternative policyholder protection schemes, including guaranty fund protections. FIO is working within a multiagency team on the OECD’s Insurance and Public Pensions Committee (IPCC), led by the Commerce Department, to provide U.S. expertise and views on relevant insurance issues. In particular, FIO’s experience in administering the Terrorism Risk Insurance Program may provide a template for other OECD

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jurisdictions. As with many topics, FIO will consult with state insurance regulators as this work program progresses.

U.S. Insurance Sector: International Competitiveness and Jobs

The Administration is working to address several country-specific concerns of the U.S. insurance industry. The office of the U.S. Trade Representative (USTR) has the lead responsibility for market access issues. Treasury, however, including FIO, provides assistance and prudential expertise as necessary, including working directly with our international counterparts on matters of prudential oversight.

China

To support Secretary Geithner's role as co-chair, FIO participated in the U.S.-China Strategic and Economic Dialogue (S&ED) held in Beijing on May 3, 2012. Implementing an earlier S&ED commitment, on May 1st, the China Insurance Regulatory Commissions (CIRC) announced that it was accepting applications from non-Chinese insurers to offer third-party auto liability insurance. The Administration welcomes this important market liberalization. During this S&ED I met with the CIRC to discuss issues of mutual concern and look forward to working with it on the prudential issues relating to bilateral and multilateral insurance matters, including those that arise at the IAIS. In this effort, as with the EU – U.S. Dialogue, we will continue to draw upon the expertise and resources of the state insurance regulators, such as the Iowa Insurance Commissioner who attended the S&ED at our invitation.

Japan

Japan Postal Insurance Company (Japan Post), benefits from its position as a state owned enterprise to the detriment of its private sector competitors. Recent legislation reverses a previously enacted privatization program and could allow Japan Post to further encroach on its private sector competitors. The Treasury Department and the Office of the U.S. Trade Representative have consistently advocated the establishment of a level playing field – including the end of anti-competitive benefits enjoyed by Japan Post as a government owned and *de facto* guaranteed entity -- as a prerequisite to new insurance product offerings. This is a long-standing issue that predates the creation of FIO, but illustrates the importance of international supervisory standards. Treasury looks forward to continued work with our USTR colleagues to resolve this problem.

Brazil

In 2010-2011, Brazil imposed regulatory measures that required 40 percent of all reinsured risks to be reinsured with local reinsurers (*i.e.* reinsurers established in Brazil), and imposed a 20 percent limit on the amount of affiliated reinsurance that can be ceded to a non-Brazilian affiliate. The reinsurance limitations imposed by Brazil restrict the investment of non-Brazilian capital into its reinsurance market. While Brazil can evaluate whether available reinsurance capital is sufficient to support a recovery from a catastrophic event, these unnecessarily

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restrictive reinsurance regulations illustrate the need for globally and fairly applied reinsurance supervisory standards.

With rare exception, property reinsurers manage risk through geographic diversification, thereby spreading risk around the world and reducing the likelihood of multiple concurrent large-scale losses. From a prudential perspective a reinsurance regulatory regime should facilitate reinsurers' ability to move risk-bearing capital from one jurisdiction to another, either through affiliated reinsurance transactions or retrocessions generally. Brazil's regime does not do that. As a global marketplace, reinsurance should be subjected to consistent and fairly applied oversight standards. FIO will work with our counterparts in the IAIS and related supervisory associations, including the Association of Latin American Insurance Supervisors (ASSAL), to develop and improve globally applicable reinsurance regulatory standards.

Conclusion

FIO provides a single point of contact and voice for the United States on prudential aspects of international insurance matters. FIO will continue to expand its engagement on international insurance matters as well as develop federal policy on these important issues. We will continue to build upon our frequent interaction with all aspects of the U.S. insurance sector – the states, the industry, and consumers – as we exercise our statutory authority. At every point and on every issue, our priorities will be a strong American economy, the creation of jobs for the American people, protection of our insurance consumers, and the fairness, efficiency, safety and soundness of both the national and international insurance markets.

I look forward to working with Congress and this Subcommittee on these issues. The U.S. and international insurance sectors are exceptionally diverse, and the objectives of sector participants are varied and numerous. As we work through these issues and assert relevant U.S. policy, we will keep you and your staff informed of developments.

Chairman Biggert and Members of the Subcommittee, thank you for inviting me to testify today to highlight FIO's early work on international insurance matters that affect the ability of U.S.-domiciled insurance and reinsurance companies to compete globally and create jobs. I am pleased to answer any questions that you have.

RAA
REINSURANCE
ASSOCIATION
OF AMERICA

STATEMENT

TESTIMONY

OF

ALLAN E. O'BRYANT
EXECUTIVE VICE PRESIDENT
HEAD OF INTERNATIONAL MARKETS AND
OPERATIONS
REINSURANCE GROUP OF AMERICA,
INCORPORATED

HEARING ON
"U.S. INSURANCE SECTOR: INTERNATIONAL
COMPETITIVENESS AND JOBS"

BEFORE

THE HOUSE FINANCIAL SERVICES
COMMITTEE SUBCOMMITTEE ON
INSURANCE, BANKING AND COMMUNITY
OPPORTUNITY

May 17, 2012

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My name is Allan E. O'Bryant and I am Executive Vice President of Reinsurance Group of America, Incorporated ("RGA"), the largest U.S.-based life reinsurer. I am testifying today on behalf of the Reinsurance Association of America (RAA), a national trade association representing life and property and casualty companies that specialize in assuming reinsurance. The RAA's membership is diverse and includes large and small, broker and direct, U.S. companies and subsidiaries of foreign companies.

Reinsurance Group of America, Incorporated is a publically traded corporation listed on the New York Stock Exchange under the symbol "RGA." We are the only global reinsurance company to focus primarily on life and health-related reinsurance solutions. Our core products and services include individual life reinsurance, individual living benefits reinsurance, group reinsurance, financial support for life insurers, specialized underwriting and life insurance product development. Our world headquarters is located in St. Louis, Missouri, and we have operations in twenty-five countries. We are listed among the group of Fortune 500 companies.

Reinsurance is simply insurance for insurers. Reinsurance is usually available for all types of insurance. RGA provides "life reinsurance," or reinsurance to life insurers. Life reinsurance is a global business and the U.S. life insurance industry is a major employer, financier of real estate projects and investor in government and corporate bonds. In 2011, worldwide net life reinsurance premiums totaled about \$ 49.2 billion.¹ These dollars were invested in U.S. and foreign government bonds, corporate bonds and stocks, as well as real estate.

¹American Society of Actuaries/Munich American Re 2011 Reinsurance Survey (excludes group and portfolio business)

Life reinsurance plays a critical role in maintaining the financial health of the life insurance marketplace and ensuring the availability of life insurance for U.S. citizens and businesses. Life reinsurance can be used to help an insurer increase the volume of business it safely writes, reduce the volatility of an insurer's loss experience, assist an insurer in meeting regulatory requirements, or enhance an insurer's financial strength. RGA is the largest U.S.-based life reinsurer, the second largest life reinsurer in North America, and the third largest in the world.² Our clients are most of the life insurance companies that you hear about on a daily basis and that sell insurance in the U.S. and abroad, but some of our clients only sell life insurance in one or two countries and have names that you may never have heard of. In 2011, RGA had reinsurance premiums of about \$7.7 billion, life insurance reinsured of about \$2.7 trillion and assets of more than \$32.1 billion.³ Of the life insurance reinsured, \$1.4 trillion was issued to persons living in the U.S., while the remaining \$1.2 trillion was issued to persons living outside of the U.S. You can see from this 51 % to 49% split, that our business is truly global.

I am pleased to appear before you today to provide the RAA's perspective on the international competitiveness of the U.S. insurance sector as well as the jobs created by U.S. firms transacting life insurance and life reinsurance in the U.S. and abroad. We applaud the Subcommittee's keen interest in this topic, and are especially grateful for Mrs. Biggert's leadership on this important issue. We also applaud the Subcommittee's acknowledgment that the international aspects of the insurance and reinsurance business require the attention of the U.S. federal government to address the needs of U.S. firms competing in the global insurance and reinsurance market. Today I would like to address domestic and international insurance regulation, state-owned insurance and reinsurance enterprises, and free trade agreements, as

² American Society of Actuaries/Munich American Re 2011 Reinsurance Survey

³ RGA 2012 Annual Report to Shareholders

these issues impact life insurers and life reinsurers. I would also like to comment on the role that we hope the newly formed Federal Insurance Office, as well as the members of the National Association of Insurance Commissioners (“NAIC”), might play in supporting U. S. insurers and reinsurers in transacting insurance business on a global basis.

THE FEDERAL INSURANCE OFFICE

First, regarding the role of the recently formed Federal Insurance Office (“FIO” or “Office”), the RAA strongly supported the 2010 adoption of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the measure which established the FIO. That legislation laid the foundation to ensure that the federal government has: 1) the authority to gather information so that it has a more thorough understanding of the complexities of insurance and reinsurance issues and how policy decisions may affect those markets; 2) the authority to coordinate federal efforts and establish federal policy on prudential aspects of international insurance matters; (3) the authority to enter into international insurance agreements on prudential matters; and 4) the authority to preempt state insurance measures that prejudice non-U.S. insurers and that are inconsistent with these international insurance agreements. Foremost among our concerns is that the FIO use its authority to take an active and meaningful international role as Congress intended. Through the FIO, the U.S. will, for the first time, be able to speak with one voice internationally and effectuate international recognition agreements with foreign nations on prudential insurance measures on an equal footing with other countries. The FIO, in coordination with the Treasury Secretary and the United States Trade Representative, should work to ensure equitable treatment for domestic, as well as foreign, insurers and reinsurers alike, promote job creation, and foster innovation and growth in the U.S. and international insurance markets.

We are optimistic and believe that the FIO, under the leadership of Director Michael McRaith, who has the experience and stature necessary to fully carryout and achieve the portfolio which Congress has handed to the Office, can function as a federal voice for U.S. firms transacting life insurance and life reinsurance business on a global basis. The ability of a U.S. firm such as our own, as well as our life insurer clients, to transact insurance business outside of the U.S., either directly or through subsidiaries, is critical to these firms' competitiveness and future growth. To ensure that U.S. firms can compete internationally, there must be a functioning U.S. governmental entity empowered to speak to and engage with foreign governments and insurance regulatory bodies for the U.S. on insurance and reinsurance issues and to advocate for U.S. consumers' and U.S. companies' interests abroad. In addition, public policy issues are often raised at the federal level which could have a significant impact, sometimes inadvertently, on the insurance and reinsurance industry. It is our hope and expectation that the FIO will be the entity that understands how decisions made by the federal government, including Congress, as well as by the states, can impact the insurance and reinsurance business. We hope that the FIO will receive the continued support of Congress in achieving these objectives. We are to date encouraged by Director McRaith's participation in the EU/U.S. "Transatlantic" Dialogue for example, as well as his participation in the meetings of the International Association of Insurance Supervisors (the "IAIS"), and we view such participation essential in helping U.S. insurers and reinsurers participate in global markets. We also support a process for a single body, perhaps the FIO, to vet insurance issues between the U.S. and other countries and to recognize, on a reciprocal basis, non-U.S. regulatory regimes.

As stated, FIO has already begun to take an active role in the IAIS dialogue and has changed the conversation from one that focuses only on U.S. equivalence to one that appreciates

the need for the EU to also be evaluated. The concept of mutual equivalence, where the insurance regulatory regimes of both the EU and the U.S. are evaluated, is being advanced by the FIO. We encourage these efforts, as we believe that the regulatory framework in place in the U.S., as expected to be enhanced by the NAIC's Solvency Modernization Initiation, will maintain world-class insurance regulation. Such regulation should not be discounted in global insurer and reinsurer solvency supervision discussions.

We also believe that the FIO will benefit from the NAIC's information and experience, and can draw from that information and experience to conduct its own analysis for the purpose of providing advice to Congress based on a perspective that is not driven by individual state interests. We commend the FIO on its coordination with the NAIC internationally as well as its acknowledgement of the NAIC's current dialogue with the IAIS on prudential insurance regulation.

The RAA wholeheartedly believes that the FIO will assist Congress and the federal government in making thoughtful decisions regarding national and international insurance policy, negotiating international insurance agreements, and enforcing international agreements uniformly across the U.S. states.

REGULATION

Now, I would like to specifically address regulation. We believe that reinsurance laws and regulations should be uniformly applied to companies operating within a single country. Differences between laws and regulations among U.S. states should be minimal. Internationally, the insurance laws and regulations of individual countries should not favor local insurers and reinsurers over multi-national insurers. As I previously mentioned, reinsurance is a global business. Encouraging the participation of reinsurers worldwide is essential because reinsurance

provides the much needed capacity for life and property and casualty risks in the U.S. and abroad and in so doing makes more insurance available at a given price. Life reinsurance not only supports insurers as they make commitments to pay claims to consumers, it also helps make more insurance available to people who would not otherwise be able to obtain a given quantity of life insurance at a given price.

We believe that supervision of insurance groups should be improved, however we do not believe that there should be global standards imposed upon only select insurers and reinsurers, without giving deference to the prudential regulation of the insurer's and reinsurer's country of origin. The IAIS has undertaken significant efforts to create global regulatory standards aimed at international harmonization. These efforts, known as the Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame"), are aimed at improving insurance group supervision and are part of a much broader project at the U.S. national and international level to understand what happened in the financial crisis of four years ago. The RAA supports the creation of a forum for discussion of global supervision of the insurance and reinsurance industry. We believe, however, that the project should be focused on improving group supervision through enhanced supervision and discussion among regulators, but not by applying global standards to a select group of insurers. Despite the NAIC's efforts to represent the U.S. in these discussions, the U.S. voice has been marginalized in these discussions because of the fractured application of the current regulatory system and the lack of a U.S. representative with authority to speak on behalf of the U.S. We are encouraged that the FIO can fill this past void and that the NAIC might work with the Office in the promotion of the U.S. interests in these discussions and promote appropriate group supervision without creating global standards that

will apply only to select insurers and reinsurers. We would simply state that regulatory supervision should be prudentially, not politically, driven.

We also believe that reinsurers should not be subject to duplicative regulation within the same country. This duplication can be avoided through the existence of a single central regulator or the existence of a group of regulators whose actions are coordinated, with no more than one of the regulators functioning as the lead regulator supervising the reinsurer. In the case of a country maintaining the latter scheme, we believe that there needs to be an empowered single voice to negotiate with foreign countries as a trading partner. We believe that an insurance trading partner was lacking for the U.S., but acknowledge that the FIO may be able to serve this role.

We also believe that laws and regulations should promote participation in the market, rather than function to limit the number of firms competing in a market. One example of laws being used to limit competition in markets is seasoning requirements. So called “seasoning requirements”, or rules that require an insurer to be in business for a prescribed number of years in order to obtain a license, are unnecessary and do not bring about healthier insurance markets. Such rules fail to focus on the quality of the insurer or reinsurer’s assets and management team. Seasoning requirements do not promote stronger insurance markets, rather, they simply limit the scope of companies that can participate in the market, resulting in less efficient insurance markets.

In our drive to improve the flow of capital for the reinsurance industry among different countries, it will be important not to put U.S. reinsurers at a disadvantage in their home market. This could happen if, for example, non-U.S. reinsurers were permitted to reinsure U.S. lives without safeguards, despite the existence of lower capital and reserving standards in place in their home jurisdictions. We have special concerns about the reinsurance of certain term life

insurance products because the U.S. states have strict reserving rules for such products that are not present in many other countries. If non-U.S. reinsurers would be permitted to provide reinsurance on U.S. term life insurance products or life insurance products featuring minimum benefit guarantees, without having to establish the strict, high reserve producing standards that are imposed upon U.S. firms reinsuring such products, U.S. firms would be disadvantaged in their ability to offer competitive prices to reinsure such products. We believe that it should be the goal of any U.S. insurance regulator, or insurance office, to make sure that a reinsurer is not disadvantaged simply because it is a U.S. firm. To this end, we would recommend that the FIO be required to use its ability to preempt state measures to ensure competitive equivalence in the U.S. market between U.S. and non-U.S. companies. Currently, under the Dodd-Frank Act, the FIO can only preempt state measures that discriminate against non-U.S. companies. There is nothing in the current law that ensures that U.S. firms will not be discriminated against.

STATE-OWNED INSURANCE AND REINSURANCE ENTITIES

Government-owned insurance and reinsurance companies create a unique problem in many countries of the world. Both U.S. and non-U.S. based insurance trade associations have taken the position that there should be equal regulatory treatment of private and state-owned insurance and reinsurance firms. These state-owned companies are frequently supervised in a more lenient manner than private companies. They also tend to be large in size and may not be required to maintain the same internal controls and risk management programs that private companies maintain. Examples in the world today include, for example, the Life Insurance Corporation of India, the Brazilian Reinsurance Institute, and Korea Post Insurance. These entities typically operate in fewer than three countries, so they may not be deemed a global systemically important insurer even though they do provide substantial amounts of insurance to

the people in the countries they serve, making their management and solvency important. If such government owned entities are not subject to the same levels of supervision provided to private firms, the private firms will be disadvantaged in their efforts to serve the same markets. This is especially true if private firms must comply with capital requirements which are more stringent than those imposed upon the state-owned entities. We do not condemn the existence or operation of state-owned insurers and reinsurers, indeed we reinsure these entities as well as private entities, and they can be quite adequately run. We do, however, believe that it would be wrong to exclude state-owned insurers and reinsurers from consideration as systemically important insurers simply because they only function in one, two or three jurisdictions.

THE IMPACT OF FREE TRADE AGREEMENTS

Free trade agreements can promote the competitiveness of U.S. insurance firms in international insurance markets by causing the U.S. and the foreign country to treat each other's insurers and reinsurers no less favorably than they treat insurers and reinsurers domiciled in their own country. These agreements also assist in harmonizing regulation of operational needs such as data privacy and data transfer standards. We are most encouraged by the recent execution of free trade agreements with Korea, Colombia, and Brazil. The true test of the value of these agreements is in the creation and enforcement of laws and regulations within each participating country that are consistent with the terms of the free trade agreement.

For example, U.S. and European insurers and reinsurers are currently faced with new privacy protection laws and data transfer rules in Korea that we believe are inconsistent with the data handling and data transfer rules agreed to in the U.S.-Korea Free Trade Agreement. The rules in Korea are unduly burdensome in that they go beyond requirements in the rest of the world by, in some cases, requiring data servers to be maintained in Korea and requiring consents

to share data with parties such as insurers, making policy administration costly, if not, in some cases, impossible. That is not only inefficient for an insurer, but it is unnecessary to achieve an appropriate level of protection for consumer privacy. While the U.S.–Korea Free Trade Agreement terms do not become effective for another two years, it is our hope that the U.S. government may be able to work with the members of the European Union in urging the Korean government to amend its data privacy and data transfer laws so that they are consistent with laws in place for similar purposes in Europe and the U.S. We note that the European–Korea Free Trade Agreement will go into effect sooner than the recently completed U.S.–Korea agreement.

There are other ways in which free trade agreements can promote offering of insurance and reinsurance products by U.S. based firms in other countries. These benefits can include protection and enforcement of agreements to protect confidential information exchanged between U.S. and foreign insurance regulators for the purpose of regulatory oversight. It may even be possible for U.S. insurers to participate in the development of insurance and reinsurance product standards in the free trade partner country.

CONCLUSION

The RAA thanks Chairman Biggert and Ranking Member Gutierrez for this opportunity to comment on international competitiveness and jobs. We look forward to working with all Members of the House Financial Services Committee and this Subcommittee as the Subcommittee considers this most important topic. In summary, the RAA fears disparate treatment of firms providing reinsurance within the same country, whether based upon a company's non-U.S. status or simply upon an arbitrary characteristic, such as size alone or private vs. state ownership. We encourage Congress to consider expanding the scope of the

FIO's charge and believe that the funding of the Office is necessary if the charge of FIO is to be achieved.

RAA
REINSURANCE
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STATEMENT

TESTIMONY

OF

MICHAEL C. SAPNAR

**PRESIDENT AND CHIEF EXECUTIVE
OFFICER**

**TRANSATLANTIC REINSURANCE
COMPANY**

HEARING ON

**“U.S. INSURANCE SECTOR: INTERNATIONAL
COMPETITIVENESS AND JOBS”**

BEFORE

**THE HOUSE FINANCIAL SERVICES
COMMITTEE SUBCOMMITTEE ON
INSURANCE, BANKING AND COMMUNITY
OPPORTUNITY**

May 17, 2012

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My name is Michael C. Sapnar and I am President and CEO of Transatlantic Reinsurance Company. I am testifying today on behalf of my company and the Reinsurance Association of America (RAA). The RAA is a national trade association representing property and casualty companies that specialize in assuming reinsurance.

I am pleased to appear before you today to provide the industry's perspective on regulatory impediments for the reinsurance business. I commend Chairman Biggert for holding this important hearing and welcome the opportunity to address the Subcommittee on Insurance, Housing, and Community Opportunity.

Transatlantic Reinsurance Company (TRC) is a New York domiciled professional reinsurer. TRC is a wholly-owned subsidiary of Transatlantic Holdings, Inc., a Delaware corporation, which is in turn a wholly-owned subsidiary of Alleghany Corporation (NYSE: Y), a Delaware corporation. TRC has over 650 employees worldwide, the majority of which are located in the United States. TRC is fully regulated in the United States with New York as its domiciliary regulator. TRC is licensed or qualified in every state, the District of Columbia, Guam and Puerto Rico and operates globally through a network of 17 branches and offices and 3 subsidiaries.¹ The worldwide branch structure is intended to be a more efficient use of capital by consolidating assets in one entity to enhance TRC's standing as a potential counterparty for reinsurance transactions.

¹ The branches and/or offices are located in: London, Paris, Bermuda, Munich, Warsaw, Panama City, Buenos Aires, Rio de Janeiro, Shanghai, Tokyo, Sydney, Chicago, San Francisco, Kansas City, Miami and Stamford. There are also three subsidiaries; Calpe Insurance in Gibraltar, Trans Re Zurich Reinsurance Company, headquartered in Zurich, Switzerland and Fair American Insurance and Reinsurance Company, a New York domiciled insurance company.

I. **BACKGROUND ON REINSURANCE**

a. **US Reinsurance Regulation – Direct and Indirect**

US reinsurers are currently regulated on a multi-state basis. While the current state-based insurance regulatory system is focused on solvency regulation with significant emphasis on regulating market conduct, contract terms, rates and consumer protection, reinsurance regulation focuses almost exclusively on ensuring the reinsurer's financial solvency so that it can meet its obligations to ceding insurers.

Reinsurance is regulated by the states utilizing two different methods: direct regulation of US-licensed reinsurers and indirect regulation of reinsurance transactions. States directly regulate reinsurers that are domiciled in their state, as well as those US reinsurers that are simply licensed in their state, even if domiciled in another state. These reinsurers are subject to the full spectrum of solvency laws and regulations to which an insurer is subject, including: minimum capital and surplus requirements, risk-based capital requirements, investment restrictions, required disclosure of material transactions, licensing, asset valuation requirements, examinations, mandated disclosures, unfair trade practices laws, Annual Statement requirements and actuarial-certified loss reserve opinion requirements.

There is also indirect regulation of reinsurance transactions through the credit for reinsurance mechanism, which is the financial statement accounting effect given to an insurer if the reinsurance it has purchased meets certain prescribed criteria. If these criteria are met, the insurer may record a reduction in its insurance liabilities for the effect of its reinsurance transactions. One of the most widely discussed criteria is the "collateral" requirement that a non-licensed reinsurer must establish in the US, such as a clean, irrevocable and unconditional letter of credit issued by an acceptable institution or a US trust fund, to cover its potential liabilities to

the insurer. This provision is based on the historic premise that state regulators do not have the regulatory capability or resources to assess the financial strength or claims paying ability of reinsurers that are not authorized or licensed in that state. As part of its recent Solvency Modernization Initiative, however, the NAIC revised its Model Credit for Reinsurance Law and Regulation. This change is intended to transition from a domicile-based system to one based upon a company's actual ability to pay, as assessed by a recognized rating organization, as well as the degree and effectiveness of financial supervision in its home country.

For several reasons, including the cumbersome nature of a multi-state licensing system, capital providers to the reinsurance market have in recent years opted for establishing new reinsurance platforms outside the US and conducting business in the US either through a US subsidiary or by providing financial security through a trust or with collateral. Following the events of September 11, 2001, 12 new reinsurers with \$10.6 billion capital were formed. After Hurricane Katrina, at least 38 new reinsurance entities with \$17 billion of new capital were formed. Nearly all of this new capital came from US capital markets, yet no new reinsurer was formed in the United States. Transatlantic Re in its current form was established in 1978; other than the US insurance subsidiaries of new start-up companies, not one US-domiciled reinsurer has been formed since 1989. For these startups, the ease of establishment, capital formation, and regulatory approvals in non-US jurisdictions contrasts with the protracted nature of obtaining licenses in multiple US jurisdictions. We believe that a streamlined national US regulatory system will make it more attractive for reinsurers to conduct business through US operations and US-based personnel. Congress has already demonstrated a commitment towards this streamlining goal when it passed the Nonadmitted and Reinsurance Reform Act (NRRRA) as part of the Dodd-Frank legislation. The NRRRA takes the first step towards streamlining state

regulation of reinsurance by providing that (1) the reinsurance company's domiciliary regulator is the sole regulator of the company's financial solvency; (2) the ceding insurer's domiciliary regulator is the sole decision maker of that company's credit for reinsurance; and (3) states cannot apply their insurance laws on an extraterritorial basis.

b. The US Reinsurance Market

Reinsurance is critical to the insurance marketplace. It is a risk management tool for insurance companies to reduce the volatility in their underwriting results and stabilize their financial performance. It is widely recognized that one of the primary functions of reinsurance is to spread natural and man-made catastrophe risk throughout the globe. Reinsurers have assisted in the recovery from every major US catastrophe over the past century. By way of example in the United States, 60% of the losses related to the events of September 11th were absorbed by the global reinsurance industry, and in 2005, 61% of Hurricanes Katrina, Rita and Wilma losses were ultimately borne by reinsurers.

Reinsurance is a global business. Encouraging the participation of reinsurers worldwide is essential to providing the critical risk transfer capacity in the US for both property and casualty business. This can be best illustrated by the number of reinsurers assuming risk from US ceding insurers. In 2010, more than 2,700 reinsurers in 106 jurisdictions outside the US assumed business from US ceding insurers.² Although the majority of US premiums ceded offshore is assumed by reinsurers domiciled in ten countries, the entire global market is required to support the enormous risk exposure in the US. Foreign reinsurers now account for 46% of the US premium ceded directly to unaffiliated reinsurers; a figure that has grown steadily from 29% in 1997.

² Reinsurance Association of America (RAA), *Offshore Reinsurance in the US Market 2010 Data* (2011)

II. Trade Barriers in General

Notwithstanding the openness of the US market to foreign-based reinsurers, and following the recent actions by the Congress and the state insurance regulatory process, many countries impose barriers on the transaction of (re)insurance business, whether by established branches or subsidiaries of non-domestic (re)insurers or by cross-border (re)insurers. These barriers can take different forms and can include:

- limitations on foreign direct investment in domestic entities;
- restrictions on establishment in a foreign country, for example, by way of legal form and the number of licenses or branches allowed to establish;
- government policies which create an unlevel playing field to the advantage of local (re)insurers, creating barriers to globalization of risk;
- nationality requirements for directors and employees;
- restrictions on international cross-border market access;
- mandatory cessions imposed on insurance suppliers to cede all or a portion of their risks to specified reinsurance suppliers;
- greater restrictions on cessions to foreign reinsurance suppliers than to domestic reinsurance suppliers;
- right of first refusal privileges for domestic reinsurance suppliers;
- unjustified prudential capital measures;
- reinsurance monopolies or unfair preferences for State-controlled companies;
- restrictions on international cross-border data flows.³

Trade barriers restrict the ability of foreign (re)insurers to compete on a fair basis in various national markets, constrain capital fungibility, restrict competition, generate needless additional costs which ultimately have to be reflected in (re)insurance pricing, and create

³ *Worldwide Barriers to Trade in (Re)insurance* paper to the OECD Insurance and Private Pensions Committee by some private sector representatives.

prudential risk by encouraging concentration of risk in local counterparties, to policyholders' ultimate detriment.

III. 2011 Global Catastrophe Losses/Importance of Industry

The 2011 global insured catastrophe losses were the highest ever recorded. Of the \$105 billion in total insured losses, the bulk of these occurred in Asia and Oceania. The 2011 losses were dominated by "mega cat" events that occurred, in several cases, in relatively small jurisdictions as measured by market size or GDP. These extraordinary losses also occurred in places where catastrophe losses are unexpected (Thailand) or were larger than expected (New Zealand).

Despite these extraordinary losses, insurance capital remains ample and for many reinsurers active in these international markets, the losses recorded were an earnings and not a capital event. According to one public report⁴, global reinsurance capital was \$470 billion in 2010; after the 2011 loss events, it declined by only 5% to \$445 billion. Of the \$105 billion in global cat losses in 2011, it is estimated that 45% (\$47.5 billion) of this loss amount was ceded to reinsurers. With regard to the largest events, the "mega events", the share that was reinsured rose to 54%. 2011 illustrates that the larger the loss generally, the greater share of the loss that flows into reinsurance markets.⁵

⁴ Aon Benfield Reinsurance Market Outlook September 2011.

⁵ The share of the 2011 mega event cat losses that were reinsured ranged from 40% to 73%. The Chilean earthquake, which occurred in 2010, had a reinsured share of 95%.

The table below summarizes the jurisdiction, the type of loss and the insured and reinsured amounts. The data is taken from publicly available sources and is based on liabilities assumed and not necessarily claims that have been paid to date.

Jurisdiction	Insured Losses (Mega Cats)	Reinsured Losses (Mega Cats)	Estimated Reinsured Share	Non-Domestic Reinsured Share
Australia	\$ 8 BN	\$ 3.5 B	44%	90%
New Zealand	\$17 BN	\$12.5 B	73%	100%
Japan	\$35-40 BN	\$12 to \$14 B	40%	98%
Thailand	\$15-20 BN	\$12 B	60%	95%
Chile	\$ 8.5 BN	\$ 8 B	95%	100%
2011 Summary:	\$75-85 BN	\$40 to 42 B	54% average	96% average
Summary (with Chile 2010):	\$83.5-93.5 BN	\$48 to 50 B	62% average	97% average

Reinsurance markets functioned well because the 2011 flooding, typhoon (cyclone, hurricane), earthquake, tsunami, brush fire, and tornado events were pooled effectively by the reinsurance business. Reinsurers of large events rely on the principles of diversification in underwriting the risk in which they assume. Pooling risk from this spectrum of cat losses, from varying jurisdictions and from perils which are not interconnected, enables reinsurance to be provided on a capital base that allows reinsurance to be priced on a basis lower than it otherwise would be priced if capital had to be held to support only a specific risk, or a specific

jurisdiction's risk exposures. This is why "ring fencing" of capital through locally mandated jurisdictional reinsurers or through government funds leads to higher reinsurance costs and less capacity when viewed over the long time horizon.

IV. SPECIFIC TRADE BARRIERS FOR U.S. REINSURERS

TRC seeks to provide reinsurance in numerous foreign jurisdictions, some of which impose onerous barriers through laws and regulations. Several of these jurisdictions are set forth in the attachment. I would like to focus my testimony on issues TRC is currently having in the European Union. Transatlantic Re has maintained a branch in the UK for over 30 years which is subject to regulation by the FSA. Examples of this include: the branch is subject to "fit and proper" requirements for key personnel; the company has biennial ARROW visits (which last time included an FSA delegation interviewing the company's board of directors in NY, senior management and its regulators at the NY DFS); the recent imposition of a requirement that the branch retain a "skilled" person (consultant) and take several steps to become more compliant with FSA governance guidelines, including hiring a local risk manager, adding additional controls and hiring a local internal auditor, all functions previously provided for by the NY head office).

The UK regulator maintains that a finding of Third Country equivalence for U.S. reinsurers under Solvency II applies only to "cross-border" transactions and that maintaining a physical branch in the U.K., however closely supervised by the FSA, requires that the third country reinsurer be Solvency II-compliant back to the home country. So, Transatlantic is confronted with a difficult choice – either close our EU branch and write reinsurance from outside the EU (such as from NY), in which case we will not have to comply with Solvency II,

or maintain a UK presence, and risk being required to be compliant with Solvency II on an organizational level even if the US is found to be “equivalent” under Solvency II.

By its actions, the FSA has indicated that the current EU rules forces TRC to form an EU insurance subsidiary, and possibly an EU holding company, to ensure that the US holding company does not need to be Solvency II compliant. Besides the enormous resources necessary to accomplish this, forcing US companies to form subsidiaries in the EU effectively ejects the few remaining US owned and controlled reinsurers from the local market and replaces them with an EU domestic. US reinsurers will cease to be a diverse source of risk management in the European market to the detriment of our reinsureds. It is worth noting that 85% of the reinsurance purchased in the US comes from outside the US; this diversity should be viewed as a strength and not as a trade imbalance. If Transatlantic maintains its current branch structure, EU policyholders will have the benefit of being reinsured by a global reinsurer with over \$4 billion in surplus.

This situation also raises a competitive issue -- if TRC is forced to form an overseas company and allocate capital to it, Transatlantic will incur significant new operating costs for such structure.

Last but not least, it is worth noting that, through changes in the Model Act for Credit for Reinsurance in 2010, the NAIC and several states have made it easier for non-US reinsurers to reinsure US business. In return, US companies with branches are apparently being ejected from the EU.

V. **POTENTIAL REFORM OF U.S. LAW TO INCREASE U.S. REINSURER COMPETITIVENESS IN OTHER COUNTRIES**

Transatlantic encourages the Committee and its members to consider the following areas of U.S. law, which impact Transatlantic's (and other U.S. based reinsurers') competitiveness, both in the U.S. and doing business in other countries:

1. The U.S. should adopt a structure that would allow for each reinsurer to be regulated by a single regulator with the power to preempt conflicting or inconsistent state laws and regulations. The single regulator's authority should provide for the recognition of substantially equivalent regulatory jurisdictions, including equal treatment of regulated entities.

2. The Federal Insurance Office (FIO) should assert its role in international regulatory bodies and use its authority to enter into covered agreements with other countries.

3. On April 1, 2012, Japan lowered its top corporate tax rate, leaving the U.S. with the highest total corporate tax rate for federal and state (39.2%) in the developed world. Simply stated, this puts U.S. business and workers, particularly those that compete globally such as in the financial services industry, at a significant competitive disadvantage. These high corporate tax rates, and the "worldwide" tax system that taxes profits generated abroad both domestically and in the country they were earned, discourages corporations from investing in operations in the United States. Two of President Obama's bipartisan "blue ribbon" panels, the Economic Recovery Advisory Board, chaired by Paul Volcker, and the National Commission on Fiscal Responsibility and Reform, chaired by Erskine Bowles and Alan Simpson, both made strong cases for cutting the corporate tax rate and reforming the entire corporate tax system.

The benefits of reducing corporate tax rates and implementing broad corporate tax reform include:

- promoting higher long-term economic growth
- improving U.S. competitiveness
- promoting higher wages and living standards
- lowering overall dividend tax rates and taxes on capital
- attracting foreign investment
- promoting lower corporate debt and reducing the incentives for income shifting, and
- easing compliance costs.

TRC wishes to thank Chairman Biggert and members of the Subcommittee for this opportunity to comment and we look forward to working with all members of the Subcommittee on these important issues.

ATTACHMENT

The following summaries provide examples of recent regulatory actions taken by foreign jurisdictions that will likely have an anti-competitive impact on foreign reinsurers including US reinsurers:

1. **Argentina and Brazil.** Reinsurance markets are characterized as being free of rate and form regulation and thus reinsurance capital flows quickly into markets unrestrained by barriers on entry. However, in 2010 and 2011, two jurisdictions imposed stringent regulatory controls on the ability to conduct cross border reinsurance business and imposed provisions to compel localized capital to be held by locally licensed reinsurers. Brazil's reinsurance regulations were designed to support a "national champion" in the IRB which is being sold by the government to private investors. The Brazilian measures are in two parts, continuing a mandate that 40% of all risk be reinsured with local reinsurers, and a 20% limit on the amounts of affiliated reinsurance that can be ceded by a Brazilian local (re)insurer to a non-Brazilian affiliate.

Similarly, Argentina's new regulations impose an array of restrictions on foreign reinsurers and their branches in Argentina. The regulations provide that the first \$50 million of insured risks must be reinsured with local companies. Foreign-registered reinsurers may only cover risks above that amount. In addition, local reinsurers (such as Argentine branches of US reinsurers) must retain in Argentina at least fifteen percent of all reinsurance premiums issued annually, and may only transfer to their foreign sister or parent companies up to forty percent of their yearly premiums. These local entities also cannot hold investments and funds outside of Argentina that exceed 50% of the company's capital. These restrictions appear to violate

Argentina's international obligations, including its obligations under the treaties of the World Trade Organization.

There are a number of other jurisdictions that also continue to impose a mandatory cession to local reinsurers (India, Thailand and China). Collectively these measures are protectionist in nature and have been the subject of protests by insurers and governments to the states that have imposed new market barriers.

Brazil's protectionist reinsurance regulations, adopted in 2011, restrict the degree to which non-Brazilian reinsurers can share Brazilian losses; thus losses are not distributed globally as they are under other mega-loss events. Under the Brazilian rules 40% of all risk must be placed with Brazilian reinsurers. If those Brazilian reinsurers are foreign controlled, they are prohibited from ceding more than 20% of their own losses to their foreign parents. Thus the impact of the Brazilian regulations is to compel mega event losses to be contained within the Brazilian economy, thus Brazil will not receive the economic boost from reinsurance recoveries that were received in 2011 in Australia, Japan and New Zealand; and in 2010 in Chile.

Brazil is not yet known to be exposed to earthquakes or hurricanes; however, it is exposed to catastrophic loss from crop failure, flooding and catastrophes that would occur to infrastructure, oil and industrial production facilities, from fire, explosion, terrorism or other man-made causes. Evidence from the US Gulf of Mexico oil spill and the Thai and Australian floods in 2011 make it clear that these loss potentials in Brazil could total billions of dollars.

The 2011 loss experience demonstrates the essential role of global risk spreading. If protectionist measures are enacted they will necessarily limit the ability to spread risk and to pool risk into legal entities where the capital is readily available to support the volatility that accompanies reinsurance of large scale catastrophe losses. Ring fencing measures such as those

imposed recently in Brazil and Argentina, and other governmental measures that mandate local government reinsurance funds, can pose further risks. “Ring fenced” capital would compel risk to be financed locally without the broad support of affiliated reinsurance; or retrocessions generally. Because diversification is restricted on a global basis the amount of capacity available for catastrophe risk is limited by the locally available capital.

Government funds, such as those that exist for earthquake in several jurisdictions and for hurricanes in one jurisdiction, impose their own unique risks. If the government funds are pre-funded, then large loss events can eliminate available funds for risk going forward. If government funds are financed on a post event basis, then risk exists that bond debt will be insufficient.

2. **Panama.** On April 3, 2012, Panama passed a new insurance law (known as Law 12) that is intended to boost the local industry and changes the way local and foreign companies do business there. Under the new law, foreign reinsurers must now register with the Insurance Superintendent and make annual filings of their financial statements, rating certificates and other documents. Prior to enactment of the new law, foreign reinsurers did not need to be registered in order to write business in Panama and simply did business on a cross-border basis.

3. **India.** In early 2012, the Indian insurance regulator (IRDA) published new guidelines for companies writing cross border reinsurance in India. The IRDA guidelines include a template for the submission of information required of reinsurers writing reinsurance business emanating from India without having a physical presence there. This information is required to be submitted to IRDA by March 31 each year. On March 29, 2012, IRDA issued an update on its guidelines for companies writing cross border reinsurance in India. The update provides that reinsurance treaties will be permitted to be placed: (1) with all reinsurance

companies registered with IRDA; (2) with reinsurance companies rated as BBB and above that are not registered with IRDA but which do so before March 31, 2013; (3) with reinsurance companies owned by government of countries recognized by the Indian government if they are registered with IRDA before March 2013.

4. **Canada.** In December 2010, Canada's Office of the Superintendent of Financial Institutions (OSFI) released final revised reinsurance regulations commonly referred to as Part XIII of the Canadian Insurance Laws. The Canadian Regulations are centered on solvency of Canadian domestic insurers and the rules concerning credit for ceded reinsurance. Unlike the US which is in the process of relaxing its credit for reinsurance rules to reduce or eliminate any collateral requirements, the Canadians have created new, domicile-based collateral requirements which determine the amount of credit that a Canadian domestic insurer can record for risks ceded to Non-Canadian reinsurers. This unfairly impacts the ability of US reinsurers reinsuring Canadian risks by requiring that a US reinsurer post collateral before the Canadian domestic insurer can take credit for reinsurance ceded to US reinsurers, regardless of the US reinsurers' financial strength.

Additionally, the Canadians have imposed other restrictions on credit for reinsurance that is ceded to foreign reinsurers that are licensed in Canada. TRC has been licensed as a reinsurer in Canada for over 20 years, with a fully staffed Toronto office and a designated Chief Agent. The current Canadian Regulations require that TRC, despite its licensed status, physically process any and all reinsurance of Canadian domestic insurers in Canada. This processing is a pre-condition for accounting credit for any reinsurance provided by TRC to a Canadian domestic insurer. For accounts produced in Canada this is generally not an issue, but where the account is produced elsewhere it becomes administratively burdensome on the reinsurance intermediary

and the ceding company as well as for TRC. By way of example consider a situation where a reinsurance agreement covers risks located primarily in the USA and Europe and has some Canadian risks as well. To comply with Part XIII the broker must segregate the Canadian portion of the reinsurance program ceded to TRC and process this portion in an office physically located in Canada and TRC must, likewise, assign this portion of the program to its Toronto office where it must be documented as being underwritten and accounted for in the Toronto branch. Also the TRC Chief Agent in Canada must sign the agreement in addition to a company official where the account originated. This applies even when the Canadian portion of the agreement is minimal. These regulatory requirements have the effect of making regulatory compliance easier and more streamlined for the reinsured domestic company if it purchases reinsurance solely from Canadian domestic reinsurers.

MetLife

Statement of

William J. Toppeta

Vice Chairman,

MetLife, Inc.

“Seeking a Level Playing Field in Regulation and Markets”

Before the

Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity
U.S. House of Representatives

May 17, 2012

Hearing on “U.S. Insurance Sector:
International Competitiveness and Jobs”

Chairwoman Biggert, Ranking Member Gutierrez, members of the Subcommittee, my name is Bill Toppeta and I am MetLife's Vice Chairman for Europe, Middle East, Africa and Asia. I spent 10 of my 38 years at the company as President of MetLife International where I had the opportunity to lead MetLife's insurance and employee benefits businesses in over 50 countries outside the United States.

You likely know MetLife to be the largest life insurer in the United States. In recent years, we have grown to become a leading global provider of insurance, annuities and employee benefit programs, serving 90 million customers in over 50 countries. Through its subsidiaries and affiliates, MetLife holds leading market positions in the United States, Japan, Latin America, Asia, Europe, and the Middle East and Africa. In 2011 our businesses outside the US contributed approximately 35% of MetLife's operating earnings.

In addition to my MetLife responsibilities, I would like to cite here some of the additional roles that influence and inform my testimony today. I represent our company's close international involvement with the US Chamber of Commerce, as well as our engagement with the American Chambers of Commerce around the world. I serve on the Executive Committee of the US-Korea Business Council, the Board of the Korea Society, and the Board of the Council of Americas. I also serve as Chairman of the Coalition of Service Industries, a group of industry leaders that champions the cause of free trade specifically in the service sector. Further, I am a past chair of the International Committee of the American Council of Life Insurers (ACLI) where I remain a member.

Although I am not testifying today on behalf of the ACLI membership, I know from my involvement there that we will be working shoulder to shoulder with other ACLI members who are globally engaged in finding solutions to distortions in the competitive landscape.

Barriers Come in All Forms

Relevant to the purpose of this hearing, MetLife's global brand promise is to help our customers overcome barriers. In our global business we have discovered a great commonality among consumers. The commonality is that there are barriers that prevent consumers from getting the financial security that they want and deserve. The barriers may vary in different countries, but we view it as our role to enable and embolden our customers to take action to protect their families and to save for retirement.

But the barriers I am here to talk about today are regulatory and market access barriers that inhibit our competitiveness globally, and the impact those competitive challenges can have on jobs. I mention the consumer barriers because for MetLife that is our primary business focus, and because the

challenges that arise from regulatory obstacles inevitably affect the affordability, availability and complexity of the products our company offers across the globe.

We recognize that coming up with the appropriate regulatory balance is not easy. Critical to today's discussion is to gain an appreciation for the costs and consequences of over-regulation or competing regulation, and that striking the right balance is a large part of the challenge.

First I plan to discuss the proliferation of regulation and the competitive challenges that represents in the global marketplace. Then I will turn to the market-specific challenges which are primarily non-tariff regulatory and market access barriers.

Our recommendations are simple. First, policymakers should weigh carefully the impacts of duplicative or conflicting regulation. Second, insurance should be regulated as insurance, not as banking. And third, policymakers should address non-tariff barriers impacting insurers operating abroad through trade agreements and intergovernmental dialogues.

I. Regulatory Proliferation and Competing Standards

It is hard to imagine an industry that has more layers of regulation than the life insurance industry, and that situation appears to be getting worse, not better. Although we favor good, strong regulation, multiple layers can actually be self-defeating to say nothing of confusing and expensive.

In the United States, insurance companies, products and agents are licensed and approved at the state level. State insurance departments also regulate company solvency and oversee consumer protection. State level regulation is influenced and guided by the National Association of Insurance Commissioners (NAIC). Federal departments and regulatory agencies, such as the US Department of Labor or the Securities and Exchange Commission, also oversee certain products sold by life insurers. The Internal Revenue Code, state revenue commissions, and state tax commissions govern the tax treatment of some products. Now, if a life insurer is deemed to be systemically important under the Dodd-Frank legislation and accompanying regulation then the Federal Reserve may apply additional regulation or capital adequacy requirements.

As Members of Congress, you are well aware of the complexities of insurance regulation in the US. You may be less familiar with the impact on our industry of G-20 initiatives to reform international financial regulation. So, it may be useful if I map out the players, how they are connected and will impact the manner in which multinational insurers, including US-based insurers, are supervised.

On April 5, 2009, in response to the 2008 financial crisis the G-20 issued a Global Plan for Recovery. This Plan established an international body, the Financial Stability Board (FSB), to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. FSB members include central banks, finance ministries, international organizations and international standard setting bodies. The United States is represented on the FSB by the US Federal Reserve, the Securities and Exchange Commission, and the US Treasury.

The global insurance industry is represented by its international standard setter, the International Association of Insurance Supervisors (IAIS). The IAIS membership comprises supervisors and regulators from some 190 jurisdictions, including major insurance markets. The US representative to the IAIS is the Director of the Federal Insurance Office (FIO) supported by the NAIC. The FIO was created under Dodd-Frank to monitor all aspects of the insurance industry, including coordinating and developing Federal policy on prudential aspects of international insurance matters. The NAIC is the organization of insurance regulators from the 50 states, the District of Columbia and five US territories.

The FSB implements G-20 initiatives through international standard setters and therefore the IAIS is charged with developing implementation frameworks for the international insurance industry.

This intersection of global and domestic policies and standard setting creates an increasingly complex global regulatory environment. Duplicative or conflicting regulations may inhibit growth and fail to address the very issues they were intended to cure. This situation may negatively affect the competitive position of US insurers with attendant adverse consequences for US customers, shareholders and employees.

I would like to address several major initiatives to illustrate my point.

Systemic Risk: Domestic and Global Designation Methodology and Prudential Measures

As we work to grow economically, we cannot lose sight of the lessons of the financial crisis. It is appropriate for regulators and politicians to focus on systemic risk issues and the increasingly global nature of the financial services industry.

Initiatives to assess and manage systemic risk in the insurance industry are under way in the US – under Dodd-Frank – and at the international level – at the direction of the FSB.

Internationally, the FSB is responsible for identifying financial institutions that may pose risk to the global financial system (global SIFIs), and for implementing measures to mitigate the risks they pose.

In the US, the Dodd-Frank Act created the Financial Stability Oversight Council (FSOC) to provide comprehensive monitoring of the United States financial system, including the authority to designate domestic systemically important financial institutions (domestic SIFIs).

Both the FSB and the FSOC will assess insurers as part of their mandates to manage systemic risk. Timing and differences in assessment and management of domestic and global SIFIs raise significant concerns that US insurance companies will be inappropriately regulated in a bank-centric manner and potentially in ways materially different from their non-US competitors. The Federal Reserve has already proposed draft rules for regulating insurers designated systemically important, but other countries are expected to do so once international standards are developed. This approach could make US companies less competitive than their international counterparts. Let me explain.

At the global level, the IAIS is developing an *insurance-specific* assessment method to identify global systemically important insurers (SIIIs). Its draft is expected to be released soon, and an IAIS November 2011 Report has already concluded that traditional insurance activities do not generate or amplify systemic risk. The IAIS continues its work on prudential measures to apply to global SIFIs with a target of end 2012.

As neither the FSB nor the IAIS has the legal authority to regulate in individual markets, they will defer to national regulators to manage any insurer designated a global SIFI.

Although the IAIS will assess and manage insurance as a distinct sector, the FSOC appears poised to apply its assessment criteria to all potential non-bank SIFIs without regard to the particular industry within which a company operates. In addition, the Federal Reserve's proposed prudential standards for non-bank SIFIs are currently bank-centric and do not adequately reflect the nature of insurance business.

As a result, US insurers may be placed at a competitive disadvantage to their non-US counterparts unless the FSOC and the Federal Reserve promptly recognize and acknowledge the differences between the insurance industry and other parts of the financial sector as they implement the Dodd-Frank Act.

All this activity must be understood against the backdrop of the general agreement by US and international regulators that there is little evidence of traditional insurance activities generating or amplifying systemic risk.

We acknowledge that engaging in material amounts of non-regulated or non-insurance activities may pose a risk to the system, but would underscore that no past insurance company failure involving regulated, traditional insurance activities has generated systemic failure. My colleague, Bill Wheeler, MetLife's President of the Americas, offered testimony to this effect yesterday before the Financial Institutions and Consumer Credit Subcommittee.

In spite of this, debate continues on whether insurance is systemically risky and proposals are put forward that would distort competition.

We propose that the most efficient and cost effective approach policymakers and regulators could take to avoiding repetitions of the 2008 crisis is to focus on unregulated and non-insurance activities. Those activities identified as problematic could be further evaluated against agreed criteria to measure the potential exposure to systemic failure.

For all these reasons, we urge the Federal Reserve and FSOC to work with the IAIS and the FSB, through the FIO and the NAIC, to coordinate the development of frameworks for the management of domestic and global SIFs based on the existing insurance risk-based framework. This would avoid inefficiency, increased costs, the creation of an un-level playing field and resulting market distortion.

Equivalence and the EU Solvency II Directive

Another example of regulation that may negatively impact the competitiveness of US insurers is the Solvency II Directive in the European Union (EU). Solvency II is an EU Directive to regulate the amount of capital that EU insurance companies must hold to reduce the risk of insolvency.

One of the components of Solvency II is a greater focus on group supervision, or looking at risks across an entire corporate group of insurance operations, in addition to assessing the solvency of each legal entity. Since many insurance groups operating in the EU also have businesses outside the EU, the EU proposes to assess the "equivalence" of these "third country" supervisory regimes for the purposes of group supervision.

It will not surprise you to learn that, as a large US-based insurer with operations in Europe, MetLife would like to see the EU recognize the US system of regulation as equivalent for Solvency II purposes. The EU concept of 'equivalence' is challenging because it tends to look at supervisory structures as well as the outcomes they achieve. We would argue that regulators should focus on the outcomes provided by regulation, rather than the structure of the regulatory system.

We are wary of premature arguments for regulatory 'convergence.' What we need at this stage is consistency achieved through mutual recognition of the outcomes of our respective systems, rather than pressure to replicate or adapt models from other countries.

In this view we are in line with our European industry counterparts. Mutual recognition will benefit consumers, markets and businesses on both sides of the Atlantic. Solvency II is also being considered as a model for adoption in numerous other markets where US insurers compete. A positive conclusion to the EU-US dialogues on insurance regulation will set a strong precedent for regulatory cooperation on insurance around the world.

Congress is in an excellent position to elevate the US-EU dialogue on equivalence. Rather than focusing on the differences between US and EU regulatory structures, the congressional spotlight can be shone on the benefits of mutual recognition, which flows to consumers, EU and US businesses, regulators and our two economies. Whenever transatlantic dialogues take place, it will be helpful to hear a chorus of congressional support for transatlantic cooperation on insurance regulation. The world's two largest insurance markets deserve the level playing field that will come from mutual recognition.

The IAIS ComFrame Initiative

MetLife supports the IAIS initiative to develop a Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), as a way to enhance group supervision. ComFrame proposes an internationally coherent framework for supervising large multinational insurers that draws on agreed international insurance core principles and standards.

We believe that ComFrame could provide the basis for greater mutual recognition and coordinated supervision. This belief is predicated on the assumption that ComFrame will be designed as a supervisory tool for comprehensive oversight that recognizes different regulatory architectures and defers to existing regulation where adequate.

There are risks of duplicating quantitative and qualitative reviews and reporting requirements, which may result in added cost for insurance groups and their clients, which could also impact competitiveness. The current draft of ComFrame recognizes this risk and defers to existing adequate national provisions for group supervision.

However, a critical portion of ComFrame remains to be developed—the so-called "common language," or the translation of the results of different capital adequacy and solvency assessment methods into numbers all supervisors can understand. We certainly appreciate the need for this common understanding. However, since global accounting standards for insurers have not yet been agreed, there is

no uniform basis for identifying a common metric at this time. Thus, moving prematurely to develop a common metric could undermine the achievement of ComFrame's most valuable and realizable goal: improving supervision of internationally active insurance groups through cooperation and consistent supervisory practices around the world.

II. Market Specific Challenges to Competitiveness

I have discussed the increasingly complex regulatory environment and the challenges it creates for US insurance companies at home and abroad. Now I would like to turn to market access barriers that can hamper the competitiveness of US insurers operating globally.

Free Trade Agreements and Life Insurers

As a life insurance company, we have operations in many countries around the world, but we do not export physical products—instead, we export competencies and expertise. This has significant implications for the creation of US-based jobs and for the obstacles we sometimes face in foreign markets.

For us, and for many in the services industries, the most important challenge to doing business is not tariffs, but non-tariff barriers that exist in areas such as regulation, investment restrictions, and data management rules, to name a few. Trade agreements are an important vehicle for us to address those non-tariff barriers to doing business abroad.

Additionally, in many markets, we compete with businesses that are either owned by or affiliated with the foreign government. Trade agreements are one of the most effective ways for us to get commitments to level the playing field for competition between state-owned or state-affiliated enterprises and private businesses like ours.

Unlike here in the US, where our competitors are other private businesses and government is the impartial regulator, in some foreign markets we actually compete against government-owned or government-affiliated enterprises. So the foreign government is both our competitor and our regulator. In FTAs foreign governments can agree to correct this imbalance.

Regulatory certainty and predictability are essential to the insurance business and the financial services market in general. Higher standards of regulatory transparency like those in trade agreements give US financial services companies greater confidence and ability to make the large capital investments needed to expand their businesses into new and growing markets.

The FTAs contain significant and rigorous regulatory transparency obligations. In the United States, we may take for granted that we know what the law requires. In many other markets this is not at all the case, making market entry, product approvals, commitment of capital, and operations less predictable.

Under the Korea US Free Trade Agreement (KORUS FTA), for instance, US insurers will have notice of, and a more meaningful opportunity to comment on, Korea's insurance regulations in a predictable manner and well in advance of these regulations taking effect. The KORUS FTA provides standardized "notice and comment" procedures for the insurance sector and grants US firms access to regulatory information on an equal basis with Korean competitors. Furthermore, it implements the adoption of a "negative list" approach for financial sector regulation, meaning insurers will be allowed to provide any product or service unless specifically prohibited or curbed by regulation. This reform is particularly useful for introducing new, innovative products to the market, benefitting consumers and enabling our business to grow.

Trans Pacific Partnership

Following the passage of the FTAs with Korea, Panama and Colombia, the next big opportunity to enhance the competitiveness of the US economy is the Trans Pacific Partnership (TPP). The TPP is a high-standard trade agreement being negotiated between the US, Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore and Vietnam.

The financial services provisions in TPP were built on the outstanding foundation established by the KORUS FTA. TPP also seeks commitments to level the playing field for private businesses competing with state-owned or state-affiliated enterprises. Not only is the TPP on track to conclude this year, but its open architecture allows for more countries to join, making it a model for 21st century trade deals.

Foreign Direct Investment Restrictions

One of the ways countries seek to protect their domestic industries is by restricting foreign direct investment (FDI) in certain sectors, usually for a limited period of time. Two of the world's largest markets, India and China, maintain tight restrictions on FDI in life insurance. In India, foreign insurers are limited to 26% FDI, and in China, the limit is 50%. This means that companies like MetLife, which want to provide world class services to customers in the world's two most populous nations, must identify local partners to invest and jointly govern their operations.

While a case was made for imposing FDI caps at the outset of developing the insurance industry in both markets, FDI restrictions are no longer valid for either market. After more than 15 years of competition with foreign-invested life

insurers, domestic insurers dominate the Chinese market with more than 90% market share. In India, the government-owned life insurer maintains more than 70% market share after more than 10 years of competing with private insurers. So the original concern that foreign companies would dominate these markets has not come to pass in either case.

FDI caps are particularly challenging for life insurers because we must commit substantial capital not only to bricks and mortar, marketing and distribution of our products, but even more so to backing up the financial guarantees we make to our customers. The initial investment period for starting up a new life insurance venture is often ten or more years, and local investors may not always have the patience or the capital to sustain such long-term investments.

Reduction or elimination of FDI caps in these key markets will take the concerted effort of the federal government through all available channels. This includes bilateral and multilateral trade agreements, dialogues such as the China Strategic and Economic Dialogue, as well as the World Trade Organization. Congress is in an excellent position to keep a spotlight on this issue, and to support ongoing efforts by the White House, USTR, and the Departments of State and Treasury to eliminate or reduce FDI caps.

III. Job Growth: The Opportunity for Financial Services Companies and Life Insurers Presented By Free Trade Agreements

The expansion of American companies into international markets has long supported economic growth and employment here at home. Insurance premium growth rates outside the United States are double or triple those here at home and in some developing markets the growth rates are even greater. This relative growth opportunity, coupled with the recent economic challenges, makes it more critical than ever for US workers and businesses to be able to compete and succeed in the global marketplace.

There are many benefits to operating internationally for US companies. For one thing, having diverse international operations provides a natural hedge for market risk. While one market might be contracting, another may well be expanding, so diverse presence helps companies balance their performance. We saw this very clearly in the recent financial crisis. While some of our markets were hit very hard by the crisis, others saw little impact or recovered very quickly (like South Korea). This geographic market diversification allowed us to sustain the number of US-based employees supporting our business as we navigated through the crisis.

To fully recover from this recession and ensure long-term growth, one of our nation's top priorities must be to create millions of jobs; and especially high paying ones like investment and export-oriented jobs that global American

companies can create. President Obama announced the National Export Initiative in his 2010 State of the Union address and set the ambitious goal of doubling US exports by the end of 2014 to support millions of jobs here at home. With the service sector generating four-fifths of our economic output, and comprising 80 percent of US private sector employment, our sector cannot afford to be handcuffed if we are to do our part in doubling exports in the near term and in so doing supporting substantial US job growth.

A recent study released by the Business Roundtable and the United States Council Foundation showed that US workers at global American companies make on average about 20% more than at companies that operate only domestically. The study confirms that American multinational companies, which account for a quarter of all private sector output and employ 22 million US workers, create more US jobs through their participation in the global economy. Furthermore, their international operations complement – rather than substitute for – domestic employment, employee compensation and investment. The equation is simple – more business overseas means more jobs at home.

To tap that overseas growth, it is essential to have free and open trade between nations, and agreements that recognize the importance of the services sector and create level playing fields for our business to compete in vibrant markets around the world. This is core to free trade agreements and why MetLife strongly supports the recently enacted free trade agreements with Colombia, Panama, and South Korea, and the pending TPP agreement.

Conclusion

The services sector is an American success story and an engine for growth and jobs. Without question, MetLife is enthusiastic about the opportunities to compete in the global marketplace.

We have three basic policy recommendations.

First, policymakers, both the in US and internationally, should weigh carefully the impacts of duplicative or conflicting regulation. Second, insurance should be regulated as insurance, not as banking. And third, policymakers should address non-tariff barriers impacting insurers operating abroad through trade agreements and intergovernmental dialogues.

Let me conclude by affirming that American companies are innovative; American workers are highly productive. Given a fair chance we can compete and win against anybody in the world.

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Statement of
J. Robert Vastine
President, Coalition of Service Industries

Before the
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity
US House of Representatives
May 17, 2012
2:00

Hearing on —US Insurance Sector:
International Competitiveness and Jobs

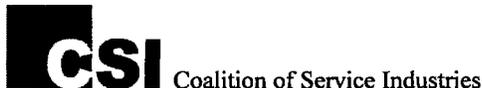
First of all, thank you, Chairwoman Biggert and Ranking Member Gutierrez, for inviting me to testify at this hearing. This is a very timely topic for discussion. The insurance market in the United States is a mature market. Our US-based insurance companies and brokers – as well as other financial services companies - are looking outside our borders to expand into new markets. Around the world, middle classes are emerging, they are buying cars and homes and building assets, and they need a way to safeguard and protect those assets that they've worked hard to earn. Insurance allows them to do just that. As a long-time member of the Congressional Services Caucus, Chairwoman Biggert, you have been a staunch supporter of services trade and growth opportunities that allow US-based companies to thrive globally and here at home. You and your staff have been a great friend and ally of services trade, and speaking on behalf of the broad membership of CSI, we applaud your foresight in holding this hearing.

On behalf of CSI, I also want to express our appreciation for the Committee's work to establish the Federal Insurance Office under the Dodd-Frank Act. We support the constructive role the new Federal Insurance Office is playing to coordinate and develop Federal policy on prudential aspects of international insurance matters, particularly in its representation of the United States in the International Association of Insurance Supervisors, in the regulatory dialogue with the European Union and in the Strategic and Economic Dialogue with China.

INTRODUCTION TO CSI

CSI is the leading business organization dedicated to the development of US domestic and international policies that enhance the global competitiveness of the US service sector. CSI represents ten leading insurance companies and associations among our 42 member organizations.

To ensure healthy expansion of the US services industries, CSI works closely with the Office of the US Trade Representative, the State Department, Commerce Department, Treasury Department, international organizations, foreign embassies, think tanks, and other DC-based



stakeholders. CSI engages with services coalitions around the world through the Global Services Coalition, which CSI co-chairs. CSI maintains a robust congressional outreach program, supporting the Congressional Services Caucus.

We are particularly grateful to the exceptionally expert and dedicated staff of the Office of the United States Trade Representative. In successive free trade agreements and many other forums they have worked to secure greater market access for our insurers and indeed, all our services companies.

SERVICES IN THE US ECONOMY

The US enjoys a strong comparative advantage in services. Services accounted for 78% of US private sector GDP in 2011, or \$11.8 trillion, and insurance accounts for nearly 3% of total GDP. Services jobs accounted for over 83% of US private sector employment. Services jobs pay an average of \$60,608 per year. In addition, workers in export-intensive services industries earn 15-20% more than comparable workers in other service industries.

The US is the strongest single services exporter. Our services exports in 2011 reached \$588 billion with a surplus of \$193.5 billion - a new annual record. US insurance exports accounted for 2.6% of all services exports in 2011, or over \$15 billion.

Although US services exports are strong, the US still has the potential to export far more services. In a recent study, Dr. Brad Jensen of Georgetown University's Center for Business and Public Policy estimates that US services exports could be about \$860 billion more than they are now. This suggests about 3 million more US jobs could be created just from increased cross-border trade, if we can remove the many, complex barriers to our services trade. This is a far more ambitious goal than the National Export Initiative, which called for doubling exports by 2014, but it requires a determined campaign of trade liberalization.

THE SERVICES TRADE NEGOTIATIONS AGENDA

CSI was founded thirty years ago to bring services to the forefront of the US trade agenda, and we believe we have achieved that goal.

The Doha Round of WTO trade negotiations, launched in 2001, raised the hopes of the global services community that serious progress could be made in achieving our goals of a fair, transparent, and open global trading system. That vision has not been realized.

During the Doha Round the US nonetheless negotiated a number of bilateral trade agreements with increasing sophisticated provisions benefiting services, including insurance.

In the "post-Doha" period there have emerged numerous forums, organizations, and other opportunities in which CSI and its members vigorously engage in order to promote insurance



trade and investment. Five key ones are the International Services Agreement, the Trans-Pacific Partnership, the US-E.U. High Level Working Group, and the Trade and Investment Partnership for the Middle East and North Africa (MENA), and bilateral investment treaties (BITs).

International Services Agreement (ISA or “plurilateral”)

A group of eighteen WTO members, of which the US is a leader, have formed the “Really Good Friends of Services” (RGF), which meets regularly in Geneva to discuss the possibility of a plurilateral International Services Agreement (ISA). These represent well more than 70% of global services trade. The ambition of the group is to fashion an agreement that will take the best elements of the FTAs already negotiated, plus the “21st Century” issues described below, and incorporate them into one FTA. We applaud the work of USTR, especially Ambassador Michael Punke, who is leading this effort in Geneva. After the long and fruitless effort to bring success in the Doha Round, the ISA offers a new pathway to achieving more open markets for insurance companies and other service providers. The ISA offers an important opportunity to establish a global standard ensuring the right to establish, and freedom from discrimination, in a transparent regulatory context.

Trans-Pacific Partnership (TPP)

The TPP provides another very important opportunity to liberalize global trade and investment in services, including insurance. Our Government, instigated by CSI and the US Chamber of Commerce, tabled a chapter providing disciplines on SOEs in the TPP at the TPP session in Peru last year. Of special concern is the effort to curb postal operators’ involvement in the insurance sector. I will discuss the importance of this bold initiative below.

CSI supports the inclusion of Canada, Mexico and Japan in the TPP, which would expand the negotiations to twelve countries, contingent upon their willingness to (1) accept the high standards being developed in this agreement, and (2) ensure that the negotiations will not be slowed down to accommodate their participation. If these countries can develop and implement their negotiating positions in accordance with these factors, they should be included in the current negotiations as soon as possible; if not, discussions should focus instead on developing a process for their integration into the agreement as soon as possible following its conclusion.

United States – European Union High-Level Working Group

The US-EU High-Level Working Group presents an opportunity to increase cooperation and services trade between these two giant services-based economies. Increased cooperation and communication between the US and EU through the High-Level Working Group could both increase opportunities for services trade between the two economies, and also improve the position of the economies in relation to third parties.



The US and the EU share a common outlook and a similar determination to maintain remarkably open insurance markets; both enjoy the benefits of liberalized services trade regimes. Both have cooperated in the WTO and other forums to expand their open approach to trade in services to other markets.

Regulatory cooperation between the US and the EU is especially important in insurance, particularly as the EU forms its Solvency II regime and other financial services regulations in response to the global financial crisis. Significant economic gains may lie in regulatory facilitation and elevating and supporting the existing regulatory dialogue. Finding ways to bridge regulatory differences to meet common objectives would be a significant achievement. To that end, a high-level regulatory dialogue should set achievable outcomes and have regular reporting milestones that will encourage private-sector participation and comment. The Federal Insurance Office has been very important in this effort.

Trade and Investment Partnership for the Middle East and North Africa (MENA)

The Trade and Investment Partnership for the Middle East and North Africa was launched last year by the Administration to strengthen business ties between the US and the MENA region. Though the US Government does not intend for the initiative to lead to trade negotiations, the goal of government agencies in developing a roadmap to encourage MENA economic activity should be to move incrementally toward our trade and investment goals. CSI formed a MENA Working Group, chaired by MetLife, to engage with the US Government in its efforts.

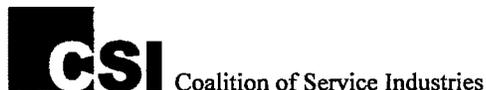
Bilateral Investment Treaties (BITs)

The US government recently announced the conclusion of the Model BIT review. This marks an important milestone and provides the US with another tool to address some of the obstacles impeding the growth of US insurers overseas.

The trade agenda for services including insurance is crowded. Progress was held back by the inability of the Doha Round to progress. We are grateful to be in a fresh new environment with many more options for progress on an array of important issues.

MARKET ACCESS AND NATIONAL TREATMENT

In all services negotiations in which the US participates, a foundational objective is to achieve access to foreign markets. For the insurance sector, and others, the keystone is to achieve the right to establish your business in a foreign market, to own it fully, and to establish in the corporate form most suitable to your business, including branches.



A recent example of a market access issue on which progress has been made is that of the mandatory third party automobile liability insurance (or MTPL) market in China. For many years foreign insurers were not allowed to write MTPL coverage in China. This restriction effectively blocked foreign firms from China's auto insurance market, which accounts for 70% of the property & casualty market, and substantially undermines the ability of US insurers to achieve sustainable development in China. Ironically, China itself had numerous problems in this market as a result of its own domestic preferential policies, including underwriting losses and lack of public confidence.

After years of engagement by the US Government, and by the US industry, China finally agreed to open this market as part of the 2012 US-China Strategic & Economic Dialogue, resulting in a true win-win for the US and China. Yet more work still needs to be done to effectively open the market, including implementing new regulations to license foreign companies and to relax current rate restrictions. As you know, China's commitments may take years to implement. We are hopeful our negotiators will continue to press this issue.

The right to establish is impaired in many countries, including the large emerging markets, by equity caps imposed by governments to bluntly limit foreign ownership. In India, the government imposes an equity cap of 26% on foreign insurers' ownership of their operations in India. In China, where Chinese firms maintain over 95% market share, foreign life insurers continue to be inhibited by a 49% equity cap.

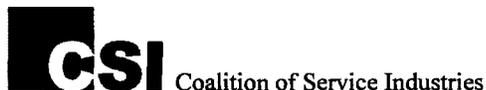
Hand in hand with the right of establishment is the right to the same treatment that a local company receives, that is the freedom from discrimination by government and regulatory authorities (also known as 'national treatment'). This is particularly important for services companies, which are typically highly regulated, and where authorities may enforce onerous licensing requirements that stifle growth and tip the playing field toward local participants. For instance, in China, foreign insurance companies are unable to apply for concurrent branch licenses. This and additional administrative challenges in China make the cost of doing business for US insurers enormously high relative to doing business in other markets.

21st CENTURY ISSUES

To reach this potential, it is imperative to address some of the 21st century issues faced by US services companies, including insurance companies, in the developing and emerging markets. These are issues that have manifested themselves more recently, and thus are not covered adequately in existing trade agreements.

State-Owned Enterprises (SOEs)

One of the most important 21st century issues is that of foreign government policies that favor state-owned enterprises (SOEs) and state-supported enterprises (SSEs). These entities are



sponsored as national champions, and they create major competitive distortions in markets around the world.

These market distortions take many different forms. Regulatory favoritism takes place when governments use policy instruments – such as regulations and subsidies – to change market results. Governments should ensure that there is a level playing field for all businesses, irrespective of ownership, and not confer competitive advantages on SOEs and SSEs at the expense of private business, including US competitors.

For instance, governments sometimes provide preferential market access to SOEs and SSEs, which adversely affects foreign companies selling to or competing with these favored domestic businesses. An example of market distortion through favoritism of state-owned or supported insurance companies are those involving SOEs that operate under the umbrella of national postal services. In many cases, the sale of insurance through post offices is a growing trend and represents a significant impediment to fair competition in insurance. For instance, Japan Post is a 100% government-owned postal entity offering not only regular mail delivery services but also insurance, banking and express delivery services, which are all in direct competition with private sector companies.

Having received different and more favorable treatment from the Government of Japan than its private sector for many years, Japan Post Insurance is now the largest insurance company in the world. The Japanese Diet recently passed legislation that will expand favorable treatment provided to Japan Post Insurance and make it easier for the entity to offer its new or modified insurance products on a discriminatory basis.

Other forms of market distortions through SOE and SSE support exist, such as preferential purchasing and sales for these entities, and provision of financial support on terms not available in the commercial market. SOEs or SSEs are often steered by explicit or implicit government mandates, incentives or informal guidance in their purchasing, sales, technology licensing or other business decisions. Non-market financing or guarantees provided by government policy enable these firms to operate on a noncommercial basis, with an unfair competitive advantage.

Data Flows

Cross-border trade in services has grown in recent years, due in large part to the internet, which has allowed worldwide electronic delivery of previously untraded services. In the current global economic climate, it is more essential than ever for this growth, and the jobs created by it, to be sustained.

Knowledge-based services, including business services, financial services, computer and information services, insurance services, audiovisual services, telecommunication, and professional services, can readily be delivered around the world via advanced communication networks. In fact, in 2006 UNCTAD estimated that ICT-enabled services constituted nearly half



of global services exports, and trade in these services has continued to grow at a rapid pace. US digitally-enables trade in services was \$116 billion in surplus last year

Such growth opportunities in ICT-enabled services are threatened, however, by the potential for restrictions on cross-border data flows. Many countries are considering restrictions on the location of storage and processing for various types of data, a problem that existing trade agreements do not address. For example, exceptions in the World Trade Organization General Agreement on Trade in Services give countries the right to regulate for national security, privacy, compliance with regulations, protection of public safety, and the prevention of fraudulent practices, to ensure the integrity of the financial system, among other reasons. Any of these reasons might be used as an excuse to block data flows and effectively create barriers to insurance and other forms of services trade.

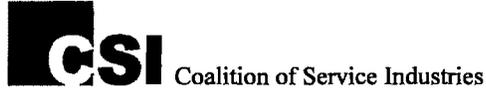
While governments have the right to regulate, they should rely on market forces, voluntary best practices and public-private partnerships whenever possible. When regulation is necessary, it should be done in the most narrowly tailored, least-trade-restrictive way possible to redress the specific and demonstrable policy concerns.

It is in the interest of the US to address these cross-border data issues in all bilateral, regional and intergovernmental negotiations and organizations. For instance, an initiative could build pursuant to the EU-US Trade Principles for ICT Services and the OECD Internet Policy Principles, and be added to the work on e-commerce and services trade in ongoing free trade agreement negotiations.

Existing outdated laws also threaten the free flow of data. Current data protection and privacy laws lack uniformity and have not kept up with the developments in the business and technological environment. Today, in multinational corporations, data no longer flows in a point-to-point manner but in a global networked environment. Thus, in order for global businesses to meet customer needs and provide efficient services, governments must refrain from unduly restricting the global flow of data.

Since regulation of data flows derives from a number of distinct legal traditions, there are significant differences in the existing mechanisms that provide for cross-border data flows. Given the growth in the complexity and volume of global data flows, as well as the changing nature of such transfers, companies with locations all over the world now need to be able to efficiently move information across national borders in order to deliver services to their customers. Yet because of the current divergent nature of privacy laws around the world, significant work still needs to be done before a truly global approach for cross-border data flows is possible. Quite simply, unnecessary data flow restrictions are an impediment that has adverse implications for consumers, businesses, and economies.

Increasingly, countries are attempting to require that all financial services data, including insurance data, be processed and stored in country. Insurers join with other services industries in calling for governments to ensure minimal disruption to the free flow of data that is vital to a



21st century economy. However as a regulated industry already subject to data use and storage restrictions, insurers would point out that they are unique in some important respects. Insurers would ask that this be borne in mind as policymakers consider policy measures addressing the free flow of data.

Forced Localization

Forced localization occurs when a country requires multinational companies to conduct their business activities domestically, or requires that business processes or hiring be conducted “in-country”. Forced localization is also a growing impediment to economic efficiency and commerce. Forced localization can take many forms and reach across many services sectors. Examples include mandating in-country data processing centers, mandating that national systems are used for all electronic payments, requiring that national banks and depositories be used for financial transactions, and requiring that percentages of employees in sectors such as oil and gas exploration be nationals of the host country, among others.

Many of the newest localization regulations have been imposed in the emerging economies. For instance, Brazil is forcing the localization of reinsurance by requiring that all insurers operating in Brazil cede at least 40 percent of their risk to local reinsurance companies. In addition, Brazil is restricting the ability of foreign insurance companies to enter its market in the first place by limiting the amount of risk that an insurance company can cede to an offshore, affiliated reinsurer to 20 percent. Argentina has taken many similar steps to force global insurance businesses to localize. Last September the Argentine Government put in place a new regulation that essentially prohibits cross-border reinsurance operations. Prior to that, US reinsurers were able to engage in the reinsurance business from the United States, either through registration with the Government of Argentina, or through brokers that are registered in Argentina. Furthermore, the new regulations require that reinsurance risks be ceded completely to domestic reinsurers or Argentine-based subsidiaries or branches of foreign companies.

As with the other 21st Century issues, the Coalition of Service Industries continues to engaged with the US government and other governments to oppose local content measures. As is the case with other forms of protectionism, forced localization in one country only encourages the spread of forced localization to other countries, to the detriment of global commerce and domestic economies alike.

Chairwoman Biggert and Ranking Member Gutierrez, thank you again for the opportunity to offer our views in this hearing. I look forward to answering any questions you may have.

THE FINANCIAL SERVICES ROUNDTABLE 
Financing America's Economy

March 14, 2012

The Honorable Timothy F. Geithner
 Secretary
 U.S. Department of the Treasury
 1500 Pennsylvania Avenue, NW
 Washington, DC 20220

Dear Secretary Geithner:

Thank you again for joining our Mid-Winter CEO Forum at the Roundtable. Our members found your candid views on critical economic issues in the U.S., and around the world, to be both informative and insightful. We also appreciate your willingness to participate in a constructive dialogue on a wide range of topics.

Throughout the Forum, a number of Roundtable members commented on the importance of the Federal Government's role in insurance industry issues, particularly the role of the Treasury Department. Collectively, the industry plays an important part in delivering financial services in the U. S., and providing financial security for individuals and their families. Additionally, the insurance industry provides jobs for millions of Americans.

It has been clear for some time that the business of insurance is vitally important to the underpinnings of our national economy and should receive proper consideration at the federal level. Congress recognized that the Federal Government should develop more expertise on insurance issues by including in the Dodd-Frank Act the creation of the Federal Insurance Office (FIO) within Treasury. We supported the creation of the FIO, and support full funding and staffing of the organization. The establishment of the FIO, for the first time, places an expert in the Department of the Treasury to increase federal understanding of the business of insurance; an industry that is unique from other financial services, both in terms of its business model and the regulatory requirements governing its financial strength.

We are also optimistic that the FIO will provide a pathway forward to improve and modernize the existing domestic state-based insurance regulatory system, and improve regulatory efficiencies for reinsurers and their customers to promote this necessary trade.

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The FIO gives the U.S. a credible and authoritative voice in the global arena that enhances the stature of the U.S. insurance and reinsurance markets. The FIO is uniquely positioned to take the lead in engagement with international bodies, such as the International Association of Insurance Supervisors (IAIS), the Financial Stability Board (FSB), and the European Insurance and Occupational Pensions Authority (EIOPA) on behalf of the U.S. insurance industry and in particular U.S.-based global insurers to assure fairness in cross-border regulatory initiatives; and to work cooperatively with Office of the United States Trade Representative (USTR) to promote accessible, competitive insurance markets globally. In addition, with the inception of the FIO, our hope is that Treasury will raise the profile of insurance in bi-lateral economic dialogues, like the U.S.-China Strategic and Economic Dialogue (S&ED), and the ongoing dialogues with Brazil, India and other key markets for financial services.

In its early stages, perhaps the most important role of the FIO, with the support of Treasury, will be to understand the impact of the Dodd-Frank Act on the industry. New regulations and requirements for some insurers – particularly those with insured depositories – must be reconciled with the realities of the insurance business. Specifically, insurers that own thrifts will now be subject to dual regulation by the Federal Reserve and the states, and we believe that the FIO should proactively assist these regulators in developing workable solutions, without imposing conflicting or duplicative requirements, as they fulfill their responsibilities.

There are other important pending regulatory activities where the FIO and Treasury should be a key resource and provide input to various regulatory agencies. For example, the Financial Stability Oversight Council (FSOC) is charged with designating nonbank financial companies as systemically important financial institutions (SIFI), thereby subjecting them to supervision by the Federal Reserve. We believe that the FIO can assist the members of the FSOC in evaluating the unique risk characteristics of insurance companies, which are very different than the risks associated with a bank holding company. Related to this, on a global scale, is the Financial Stability Board's process for designation of so-called global systemically important financial institutions (G-SIFI). We believe the FIO has an important role to play here as well to assure an open, consultative process appropriately coordinated with national rulemaking, including that of the FSOC.

Furthermore, the Federal Reserve is charged with writing more stringent enhanced prudential standards rules that will apply to nonbanks that are designated as systemically important. The FIO and Treasury should assist the Federal Reserve in evaluating how these rules could impact the business model, capital structure and statutory risk factors of insurance companies, in the event any insurance groups are designated pursuant to such rules. Here again, FIO can help coordinate with the parallel international process. Likewise, consistent with Congressional intent to appropriately accommodate the business of insurance within an insurance company, FIO and Treasury should provide meaningful input into the insurance activities provision and other provisions of the Volcker rule that impact insurers. More broadly, we recommend that the FIO serve as a resource and sounding board for any proposed federal statutes or rules that significantly affect the business of insurance. A current

example is the Department of Housing and Urban Development's (HUD) new proposed rule on disparate impact.

Our hope is that the FIO will play a significant role, in concert with other insurance experts on the FSOC, in ensuring that any new regulation imposed on insurers is commensurate with the risk targeted for mitigation. The FIO and Treasury should help avoid the cost of any new Federal or international regulation impacting insurance companies that is inconsistent with any reasonable risk presented by insurers or that imposes redundant regulation on matters already regulated by state insurance departments or other agencies. Finally, FIO should help provide understanding as to the impact of the economic environment on insurers, as well as promote market access and a balanced international regulatory architecture.

We look forward to working closely with the Treasury and the FIO to ensure that the U.S. remains a healthy and vibrant market for insurers, reinsurers and their customers.

Best regards,

A handwritten signature in black ink, appearing to read "Steve Bartlett".

Steve Bartlett
President and CEO
The Financial Services Roundtable

cc: Neal S. Wolin, Deputy Secretary, U.S. Department of the Treasury
Michael T. McRaith, Director, Federal Insurance Office



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**STATEMENT
OF
AMERICAN INSURANCE ASSOCIATION
ON
U.S. INSURANCE SECTOR: INTERNATIONAL COMPETITIVENESS
AND JOBS
BEFORE
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY
OPPORTUNITY
OF
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL
SERVICES**

MAY 17, 2012

Distinguished Chairman and Members of the Subcommittee,

The American Insurance Association represents a diverse membership of 300 insurers that write more than \$100 billion of premium annually in the U.S., and provide virtually every kind of property and casualty insurance coverage throughout the world. These companies are well capitalized, having weathered the financial crisis and recent natural catastrophes, and many have the interest and financial capacity to expand their global operations. At the same time, there is a tremendous unmet demand for insurance in much of the world, including especially in the emerging markets.

There is, however, a current disconnect between the significant global insurance capacity and the strong global insurance demand, that is largely created by protectionist barriers to trade often masquerading as regulation. The lost opportunities that result from these barriers not only adversely affect our companies, but also deny the many social benefits of insurance desired and needed by the rest of the world. Because it is in the economic and strategic interest of the U.S. to do everything we can to reduce these barriers, we appreciate Congress' focus on insurance trade barriers and related regulatory issues.

Both the Capacity to Write Insurance and the Global Demand for Insurance Are High.

National and international observers have documented that property and casualty insurers, despite the recent challenges, remain strongly capitalized and able to take on more business. In addition, insurance regulation in the U.S. and other developed markets is comprehensive and performed well during the financial crisis.

The potential growth in insurance is well documented by sources such as Swiss Re's Global Insurance Review 2011 and Outlook 2012/2013 (December 2011). According to that report, non-life insurance in industrialized countries is expected to grow 1.7% in 2012 and 2.9% in 2013. But in emerging markets, the growth is predicted to be 7.0% in 2012 and 8.6% in 2013. This latter set of numbers includes the expectation of South and East Asia growth of 10.6% in 2012 and 11.5% in 2013. Thus, as more countries in Latin America, Asia, the Middle East and Africa develop, their demand for insurance is expected to grow dramatically, as these numbers show.

Regulatory Barriers Are Standing in the Way of Insurers Meeting the Global Demand for Insurance.

The U.S. International Trade Commission (ITC), in its 2009 report, Property and Casualty Insurance Services: Competitive Conditions in Foreign Markets, well documented the extent to which foreign barriers to trade are inhibiting the international growth of U.S. insurers. Using a carefully constructed Insurance Trade Restrictiveness Index as a basic set of criteria for a liberalized market, the ITC concluded that if countries in its sample were completely open, the direct sales of U.S. insurers would increase 48%, or \$870 million annually while the sales of the affiliates of U.S. insurers would increase 28%, or \$39.1 billion annually. The ITC then estimated the U.S. job growth that would be possible if the barriers to trade were eliminated.

Trade Barriers Not Only Harm Insurers but Also Harm Potential Policyholders and the Countries in Which They Reside.

Insurance plays many roles in supporting economic development and improving the quality of life. Of course, insurers provide compensation for losses sustained by individuals and businesses. Not only do insurance claims payments benefit the victims, but they free up

government resources that would otherwise be spend on recovery to be expended for other purposes.

Insurers invest premiums until needed to pay claims. Because of the conservative business model of insurance and its regulation, these investments are heavily placed in government bonds that, in turn, finance roads, bridges, hospitals and ports. In the U.S. for example, property and casualty insurers held more than \$300 billion in government securities. In combination, this infrastructure investment both supports economic growth and provides a higher quality of life.

Insurers also help societies identify and mitigate risk. This occurs through risk-based pricing, loss control services and political advocacy for safer workplaces, safer roads and safer buildings. As an example, the U.S. Department of Transportation recently announced the lowest number of highway fatalities and the lowest highway related fatality rate in recent history. This improvement came about largely through longstanding advocacy for better car designs and behavior modification through seatbelt and anti-drunk driving laws and public information. Insurers have often been among the leaders in these efforts. Now, insurers have turned more attention to building safety, with the opening of a major new test facility last year.

Thus, barriers to trade reducing private insurance activity harm not only the insurers but the public. Reducing those barriers is therefore a “win/win” for the industry and for the people of countries that open their insurance markets.

Insurers Are Innovating to Meet Changing Needs and Nontraditional Markets.

Our members not only write traditional insurance but also have the ability to offer nontraditional forms of coverage. For example, some write takaful, a coverage reflecting Islamic values. They also provide ‘inclusive insurance’, formerly called micro-insurance, offering coverage with small payouts and with premiums affordable for the very poor.

Achieving U.S.-EU Mutual Recognition Is a Current Issue and a Very High Priority.

Europe’s new financial solvency system for insurers is set to go into effect at the beginning of 2014. Under it, a third country must be deemed equivalent for purposes of reinsurance, group capital and group supervision, if a company originating in that country is to be treated equally with European insurers in the European market. Omnibus II, the follow-on measure to Solvency II, is now being debated in Brussels, including how this equivalence process will work, with transitional provisions.

Meanwhile, the U.S. and EU have an intensive regulatory dialogue involving the Federal Insurance Office, National Association of Insurance Commissioners and State regulators to determine how differences between the two regulatory systems can be bridged so as to allow an equivalence finding for the U.S. While there is widespread hope on both sides of the Atlantic that this process will produce results, Congress should be monitoring the situation to assure that

mutual recognition is the ultimate outcome and that trans-Atlantic insurance commerce is not disrupted.

International Association of Insurance Supervisors' (IAIS's) Global Standard Setting, Including G-SIFI Methodology and ComFrame, Requires Constant Engagement.

As an Observer, AIA has been continuously engaged in all of the IAIS regulatory activities and work streams. Of greatest concern now, is its process for determining a G-SIFI methodology for insurers in response to the delegation from the Financial Stability Board. Most important to us is that this G-SIFI process be in sync both with the criteria and timing of the U.S. SIFI process under Dodd-Frank. It would make no sense for insurers not deemed systemic in the world's largest insurance market to face a contrary designation in the global market, using different, and perhaps inappropriate, criteria. Congressional focus on the international process to assure a consistent outcome with the U.S. process would be very helpful.

IAIS is also nearly mid-way through the creation of the Common Framework for the Supervision of Internationally Active Insurance Groups. So far, it has taken the path of imposing new requirements on globally active insurance companies, many of which are potentially U.S. based, depending on the definitions. We urge that Congress follow this project and insist that it not impose new layers of regulation, but instead that it create a framework of clear roles and responsibilities for supervisors so there are no gaps and also no duplication of regulatory functions.

Lack of Regulatory Transparency and Due Process Are a Consistent Issue for Insurers.

The U.S. is increasingly focused on streamlining its regulatory system, as witnessed by actions of the Congress and the Administration to engage in cost/benefit analysis and reviewing existing regulations to see if they should be repealed. In addition, Organization for Economic Cooperation and Development (OECD) countries (including the U.S.) have agreed to implement sound regulatory principles embodied in the OECD's Policy Framework for Effective and Efficient Financial Regulation. Among the OECD's recommendations for regulating financial services, including insurance, are: precise identification of the problem, selection of the policy option that is least costly to the industry but still effective, and periodic review of existing regulations.

Few countries, even OECD members, actually apply this framework and it seems not to be consistently followed by international standard setting bodies. We therefore request the Congress to inquire as to how the OECD framework is being followed in bodies in which the U.S. participates and by trading partners of the U.S.

Unfair Competition from State Owned or State Related Enterprises Is a Widespread Challenge.

There is a constant danger that current or former state owned enterprises are allowed to compete unfairly with foreign insurers, including those based in the U.S. Often they are able to do so because they are subject to different and lower regulatory standards, because they enjoy cultural and historical advantage, or both. Examples include Japan Post and Korea Post. We urge the Congress to be supportive of efforts to prevent and eliminate such advantages. A good example of a countermeasure is the language on Korea Post in the Korea-U.S. Free Trade Agreement.

Retrenchment by Major Regional Leaders, Such as Argentina and Brazil, Is Becoming an Alarming Trend.

These two countries are among Latin America's regional leaders. Both however have backpedaled on liberalization in critical and severe ways. Argentina may be violating its WTO commitments and is harming the insurance sector, as it is other sectors, in the drive to force the localization of capital.

Brazil liberalized its market by phasing out the reinsurance monopoly. Recently, however, the Finance Minister reversed that progress and limited foreign reinsurance cessions and mandated local reinsurance. All efforts have failed to achieve even a good faith discussion of the issues with Brazil. We therefore urge that Congress lend its weight to emphasize how strongly the U.S. protests the actions and requires that they be reversed.

China Shows Slow Progress in Granting True Competitive Market Access.

Twelve years after China's accession to the World Trade Organization (WTO), the country's insurance market remains extremely challenging for foreign insurers. As a result, some major foreign insurers have exited the market or substantially reduced their holding.

We have long engaged in issues in China and have seen some progress, including reducing minimum capital standards, improved regulatory transparency and the promised opening of the mandatory third party auto liability insurance market.

Many issues remain, however. For example, licensing is still consecutive by region and there are too many costly burdens imposed on each foreign insurance company office. These are both among the factors that slow expansion and limit the ability to bring new products and progressive practices to the China insurance market. Congress' constructive interest in continued progress on these issues is helpful.

India Shows Little Inclination to Increase its 26% Foreign Direct Investment Cap.

Despite repeated communications and promises of action, India's 26% foreign direct investment cap continues in force. This is particularly egregious, considering the size and sophistication of the Indian insurance market and its desire to be a global leader. Congressional interest in resolving this issue should be signaled in talks with India.

The Trans-Pacific Partnership (TPP) Offers Some Opportunities for Progress if We Set a High Bar.

AIA applauds the process so far in the talks and has supported consideration of the addition of Canada, Japan and Mexico, provided they do not dilute market access commitments and do not delay the negotiations. We urge Congress to remain engaged in these discussions to assure an outcome in insurance at least as beneficial as the results achieved under the Korea-U.S. Free Trade Agreement, with regard to limits on the postal service writing insurance, national treatment, movement of data, and consultation and dispute settlement mechanisms.

Privacy Concerns May Be Leading to Controls that Unnecessarily Inhibit Cross-Border Data Flows Needed by Insurers.

We are concerned with a growing trend to restrict the ability of insurers to analyze data outside the country of origin. This would, of course, add to operational costs and limit the competitive advantage our companies can achieve through centralized data processing and analysis. It is important therefore, that we assure that new privacy laws not inhibit the necessary transmittal and use of data for legitimate insurance purposes such as underwriting and claims settlement.

We Continue to Support Efforts to Achieve Real Progress at the WTO.

AIA has long been an active supporter of the multilateral trading system. WTO commitments can make a critical difference, because they are long term and are enforceable. However, the WTO has recently been ineffectual at achieving new market access. For this reason, we support reasonable efforts, such as a services plurilateral to try and end the impasse.

Conclusion

We appreciate the attention of Congress to these international trade and related regulatory issues. Without this focus, we fear that the global expansion of U.S. insurance companies may be inhibited, thereby harming not only our economic interests but also stunting the economic development of strategic partners.

Respectfully submitted,

David F. Snyder,
Vice President and Associate General Counsel
American Insurance Association

Statement for the Record

The House Financial Services Committee

On

U.S Insurance Sector: International Competitiveness and jobs

On behalf of

The Council of Insurance Agents and Brokers

May 17, 2012

The Council of Insurance Agents & Brokers (The Council) appreciates the opportunity to submit a statement to the House Financial Services Committee on international insurance regulatory matters. A coordinated dialogue on international insurance issues at the federal level is a welcome development for insurance brokers. Strengthening America's voice on insurance matters in the international arena has been a long-sought goal of our membership as the insurance marketplace becomes increasingly global and the insurance industry – including our members – seek to enter markets, compete fairly, and serve their clients' interests around the world. As the focus on the insurance industry as part of the global review of the financial services sector intensifies, the stakes have never been higher and the importance of federal involvement never clearer.

We would like to take this opportunity to provide the following information to serve as an introduction to the most critical issues facing insurance brokers internationally.

The Council represents the largest and most successful property/casualty and employee benefits agencies and brokerage firms. Council member firms annually place more than \$200 billion in commercial insurance business in the United States and abroad. Council members operate both nationally and internationally, with nearly one in five members with presence outside the United States, conducting business in some 30,000 locations, and employing more than 120,000 people worldwide.

Coordinating international insurance regulatory policies is critical to insurance brokers, insurance consumers, and to U.S. economic growth. The U.S. insurance industry creates American jobs by exporting its products and services and by helping other U.S. industries take the risks they need to grow globally. Initiatives that open global insurance markets and create a level playing field will provide brokers the structural framework needed to allow them to service their clients wherever they operate around the world, thus benefitting the U.S. economy and job market, and, indeed, economies around the world. Much remains to be done, however, to reach

these goals. To that end, we believe that the creation of the Federal Insurance Office (FIO) is a game changer, the importance of which cannot be overstated.

Until the creation of the FIO under Title V of the Dodd-Frank Act, the U.S. lacked a single authoritative voice on international insurance matters. The FIO now brings together under one Federal office the authority to coordinate U.S. international insurance efforts. Furthermore, its advisory authority to the Secretary of Treasury on “major domestic and prudential international insurance policy issues,” will elevate insurance priorities to a level equal with banking and securities.

The Council enthusiastically supports FIO’s international authority and particularly looks forward to having a single U.S. voice engaging with the International Association of Insurance Supervisors (IAIS), as opposed to the state insurance regulators who have no authority to speak for the U.S. government on insurance policy matters. (Having said that, we note that the state regulators, through their trade association, the National Association of Insurance Commissioners (NAIC), remain involved with IAIS, and we believe their technical expertise will remain important in supporting the FIO and IAIS efforts.)

The IAIS has, among other responsibilities, international standard setting authority granted by member nations of the G-20. The IAIS’s standard setting authority, which is a fairly recent development, makes it even more critical that the interests of the U.S. insurance sector, from the market and regulatory perspectives, are methodically coordinated and represented by a federal office. The single voice that the FIO brings to the IAIS will be critical in ensuring that the U.S. perspective will be heard and heeded in that group’s development of “principal” papers on the regulation of intermediaries and insurance companies. These papers are intended to guide regulators around the globe on “best practices” in the development of insurance regulatory structures and rules, and it is critical that the U.S. approach to regulation have a strong advocate. Despite our concerns with the redundancy of 51+ different insurance regulators in the U.S. system, we generally believe that the U.S. approach – upfront licensure, with back-end enforcement – is one that works. To that end, we believe the FIO is better suited to represent American interests, than representatives of the individual state insurance commissioners. The FIO’s voice will strengthen insurance regulation, business development, and the broader U.S. economy. We look forward to working with the FIO, Congress, and international bodies on global issues impacting our sector and its global competitiveness.

Together with international regulatory standards, the FIO has an important role working with USTR in advancing U.S. insurance interests in international trade discussions, which are critical to insurance brokers and the entire industry as the U.S. marketplace matures and insurance is increasingly global in scope. Brokers’ business interests in the international arena are driven by issues impacting access to foreign and emerging markets, increasing regulatory transparency overseas, servicing U.S. business clients abroad, boosting international regulatory cooperation, and the development of international regulatory standards. Market liberalization policies that ease access for U.S. brokers and the insurance community will be a critical component to lifting the global economy, including the economy here at home, and creating American jobs. For example, the President’s National Export Initiative seeks to double U.S. exports by 2014, by increasing scrutiny on international insurance hurdles and demanding for cooperative and sound

international regulations. Market access and trade liberalization policies go hand in hand with economic growth strategies. The USTR has provided excellent leadership on this front for insurance brokers and in representing our interests in trade negotiations. The FIO can be of particular help in ensuring the USTR's success by using its bully pulpit to advance the interests of the U.S. insurance sector and by coordinating efforts to resolve any conflicts between the federal government and states over insurance.

To boost market access and regulatory cooperation, The Council is focused on the following areas of concerns;

- Removing unnecessary restrictions on the right of establishment of foreign insurance intermediaries. Insurance intermediaries should have the right to establish operations in a foreign country through either a wholly owned operation or some other business ownership vehicle. For example, Chinese and Indian governments continue to hinder growth opportunities by imposing strict ownership and joint-venture restrictions on foreign companies.
- Allowing foreign insurance intermediaries to compete on a level playing field with local intermediaries, with the same access to domestic and international markets. Foreign and domestic intermediaries should be treated as equals for regulatory and other purposes. For example, emerging markets for reinsurers like Argentina and Brazil impose lopsided regulatory burdens that favor domestic companies and ultimately punish consumers by increasing their liability with risk resulted by the lack of true market access.
- Removing unnecessary restrictions on cross-border insurance placements. All professional insurance intermediaries should be permitted to place business in the most suitable market for each risk and to render related services without being required to establish in the country where such services are delivered. This is of particular importance for marine, aviation, and transport placements, as well as for clients facing international risks, large-scale commercial undertakings, or the need for reinsurance support. As global trade expands, brokers face the challenge of placing insurance policies to cover global risks. "Master policies" are often used for certain types of global business risks, i.e. global property, Difference in Conditions (DIC) policies, umbrella liability, D&O liability and E&O coverage. The use of these policies can offer distinct advantages to the consumer by providing comprehensive coverage, helping to avoid coverage gaps and protecting the balance sheet. Furthermore, a master policy can help the insured manage its multi-national risks more efficiently. Unfortunately, there are many regulatory barriers to placing global policies. Conflicting tax and insurance laws and regulations country-to-country make it difficult to effectively use these policies.
- Removing unnecessary restrictions on the purchase of services from insurance intermediaries. Because insurance brokers facilitate trade in all sectors, exporters and importers of goods and services, along with parties to multinational or large undertakings, should have the right to choose an insurance broker based on professionalism, access, insurance expertise, and the commitment to long-term service. This marketplace should ideally be global in scope. However, unnecessary restrictions on monetary transfers and

restrictions on the exchange of information and technical services are hindered by undue foreign regulation.

- Creating a system of easily obtainable and renewable permits. This could facilitate the temporary posting of key business personnel so host countries can begin to enjoy the benefits of foreign agent/broker investment without undue delay.
- Promoting trade liberalization through WTO membership requirements. Countries seeking membership in the WTO should include commitments to liberalization of the insurance markets, resulting in commercially meaningful access.
- Increasing regulatory transparency. Domestic regulations impacting foreign companies should have a transparent and open process that allows for engagement and predictability.

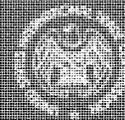
Council members are involved in producing property/casualty and employee benefits insurance in every region of the world and assist client portfolios that are poised to lead the global economic recovery. Increasing access market access across the globe, easing regulatory barriers and promoting transparency and cooperation among foreign regulators are critical to enable our industry to grow and prosper – and to enable us to help grow the U.S. and global economies.

The Council very much appreciates the opportunity to submit this statement for the record and looks forward to working with the committee on international issues moving forward. If you have any questions or would like more information, please contact Joel Kopperud at joel.kopperud@ciab.com.

United States International Trade Commission

**Property and
Casualty Insurance
Services:
Competitive
Conditions in
Foreign Markets**

Investigation No. 332-499
USITC Publication 4058
March 2009



U.S. International Trade Commission

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**Property and Casualty Insurance Services:
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Abstract

The global property and casualty (P&C) insurance market, measured in terms of total revenue, is concentrated in three geographic regions, North America, Europe, and North Asia (Japan, China, and Korea), with automobile insurance representing the single largest market segment. Overall, the P&C insurance markets of developed countries are mature, whereas the markets of many developing countries are growing rapidly. Demand for P&C insurance services is driven by many factors, including economic growth and compulsory lines requirements, whereas the supply of such services is a function of the number of competing firms and the regulations imposed on such firms. P&C insurance is sold in global markets through cross-border trade and through the sales of affiliates located in foreign countries, with affiliate sales accounting for the dominant share of international trade. Although most countries establish prudential regulations pertaining to the provision of insurance services, Commission research suggests that many countries maintain nontariff measures (NTMs) that restrict the participation of foreign insurance firms in domestic markets. Econometric models developed by the Commission estimate that NTMs have a significant effect on the profitability of insurance companies in foreign markets. Moreover, the model results suggest that removal of NTMs in foreign countries would result in increased U.S. cross-border insurance exports and affiliate sales, and result in higher levels of employment in the U.S. P&C insurance industry.

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Executive Summary

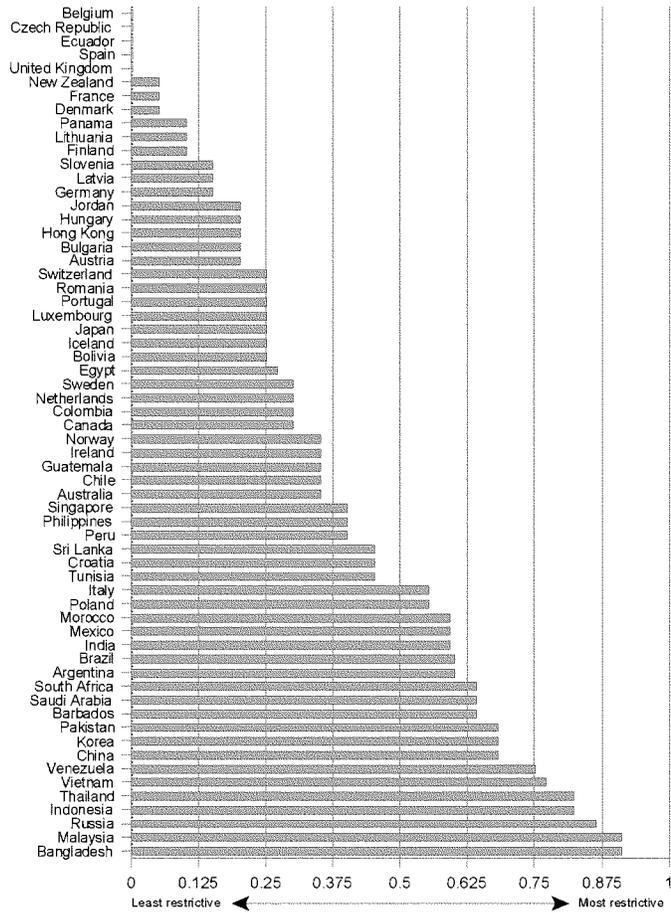
This report, requested by the United States Trade Representative, focuses on the property and casualty (P&C) insurance industry. P&C insurance protects a person or business from damage to, or loss of, insured property, as well as legal liability for losses caused by injury to other people or their property. P&C insurance is divided into personal lines and commercial lines. P&C insurance contributes to economic growth and development by mitigating financial volatility resulting from large losses, motivating investment in property and commercial activity with inherent risks, and facilitating commerce and trade.

Key Findings

An inventory of 72 countries reveals a multitude of nontariff measures (NTMs) that limit access to, and competition in, national markets for P&C insurance. Many of the countries most encumbered by NTMs also have the highest insurance premium growth rates and the lowest levels of insurance penetration, making them potentially attractive markets for U.S. firms.

In order to systematically examine NTMs across countries, the Commission developed an Insurance Trade Restrictiveness Index (ITRI). The ITRI facilitates cross-country comparisons (figure ES.1), and serves as the trade policy variable in econometric models used to examine the effect of NTMs on P&C industry profits, trade, and employment. The ITRI survey shows that Belgium, the Czech Republic, Ecuador, Spain, and the United Kingdom are among the most open P&C insurance markets.

FIGURE ES.1 Insurance Trade Restrictiveness Index (ITRI), selected countries



Source: Compiled by Commission staff.

Note: The ITRI value for Belgium, Czech Republic, Ecuador, Spain, and the United Kingdom is zero.

The Commission's econometric analysis suggests that P&C insurers' adjusted profit margins in the most restrictive markets—Bangladesh, Malaysia, Russia, Indonesia, Thailand, Vietnam, and Venezuela—are inflated by more than 35 percent due to trade restrictions. As such, liberalization in these countries may promote economic growth and stability by providing individuals and businesses with the means to manage risk at more affordable prices.

The Commission's analysis also suggests that cross-border exports and sales by U.S.-owned affiliates abroad could expand markedly if foreign insurance markets were liberalized. For example, a 10 percent reduction in foreign restrictiveness could increase U.S. exports by 9.9 percent. If all countries examined were to fully liberalize, U.S. exports could increase by 48 percent, or \$870 million.

Liberalization could produce an even greater effect on affiliate sales, the predominant means of trade in P&C insurance. The Commission's analysis indicates that a 10 percent reduction in foreign restrictiveness could yield a 14.5 percent increase in the sales of U.S. affiliates. If all countries fully liberalized, U.S.-owned affiliates could increase sales by 28 percent, or \$39.1 billion.

The Commission's partial equilibrium analysis also offers support for industry representatives' statements that, in the event of foreign liberalization, the establishment of P&C affiliates in overseas markets could produce an increase in the U.S. P&C industry's domestic employment. Under such circumstances, U.S. P&C employment could increase by 0.72 percent, meaning that a firm with 10,000 employees could add 72 positions in its U.S. offices. Many of these jobs would likely pay well above the average U.S. wage.

Market Dynamics

The global market value of P&C insurance, measured by total revenue, grew by 5 percent in 2007 to \$1.5 trillion. More than 90 percent of the global market was concentrated in three geographic regions: Europe (45 percent), North America (38 percent), and North Asia (China, Japan, and Korea) (9 percent).

With the exception of select insurance firms dealing in mortgage-related securities, the P&C insurance industry is one of the healthier subsectors of the financial services industry. Thus far, the financial crisis has mainly impacted P&C insurance firms through their investment portfolios, which have experienced negative returns due to global financial market turmoil.

The P&C insurance markets in developing countries are growing faster than those in developed countries, spurring greater interest in entering and competing in those markets. In 2006, total premiums in the developing countries grew at an annual rate of 19 percent, compared to a rate of 3 percent in developed countries.

Insurance firms sell P&C insurance in global markets via both cross-border exports and affiliate sales, with the latter estimated to be as much as 30 times larger. During the 2000–2006 period, U.S. cross-border exports grew by 31 percent. The fastest growing U.S. export markets included Switzerland, Canada, the Philippines, and Malaysia. U.S.-

owned affiliates' sales grew by 8 percent during the 2000–2005 period, with the largest host markets being the United Kingdom, Ireland, and Canada.

Acronyms

ABI	Association of British Insurers
ABS	Asset-Backed Securities
AIA	American Insurance Association
AIG	American International Group
BEA	Bureau of Economic Analysis
BLS	Bureau of Labor Statistics
CAGR	Compound Annual Growth Rate
CDS	Credit Default Swap
CIAB	Council of Insurance Agents and Brokers
CSI	Coalition of Service Industries
FDI	Foreign Direct Investment
FLG	Financial Leaders Group
FLWG	Financial Leaders Working Group
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
IFSC	International Financial Services Center
IMF	International Monetary Fund
ITRI	Insurance Trade Restrictiveness Index
MAT	Marine, Aviation, and Transport
NAIC	National Association of Insurance Commissioners
NAICS	North American Industry Classification System

Acronyms—Continued

NTM	Nontariff Measure
OECD	Organization for Economic Cooperation and Development
P&C	Property and Casualty
PRI	Property Rights Index
RAA	Reinsurance Association of America
TRI	Trade Restrictiveness Index
UNCTAD	United Nations Conference on Trade and Development
USITC	U.S. International Trade Commission
USTR	Office of the U.S. Trade Representative
USDOC	U.S. Department of Commerce
USDOL	U.S. Department of Labor
WDI	World Development Index
WTO	World Trade Organization

Glossary

Agent—An individual who sells insurance, either as an independent or captive agent. Captive agents sell insurance for only one insurance company, whereas independent agents sell insurance for multiple companies.

Asset-backed security—A financial security backed by a pool of loans, typically loans of similar type, duration, and interest rate. The issuer of such securities uses the cash flow from loan payments to fund interest payments on the security. Almost any type of loan with regular principle and interest payments can be securitized, including auto loans, credit card receivables, and mortgage loans.

Bancassurance—The practice of selling insurance through banks and/or postal centers.

Broker—An individual that acts as an intermediary between a client and an insurance company; brokers typically work on behalf of clients, rather than insurance companies.

Captive insurance company—A company that is created and funded by one or more noninsurance companies to provide the owners with insurance coverage; a form of self-insurance.

Commercial line—Property and casualty insurance for businesses and other institutions.

Compulsory insurance—Insurance coverage required by law. For example, many countries require automobile owners to carry a minimum amount of automobile liability insurance.

Directors and officers (D&O) errors and omissions liability insurance—D&O liability insurance, a type of P&C insurance, covers directors and officers of a company for negligent acts or omissions, and for misleading statements that result in lawsuits against the company.

Insurance density—Insurance premiums per capita; the ratio of total insurance premiums in a country divided by that country's total population.

Insurance penetration—The ratio of total insurance premiums in a country divided by that country's national gross domestic product.

Marine, Aviation, and Transport (MAT) insurance—Insurance covering goods in transit as well as the commercial vehicles that transport them via land, air, or water.

Mortgage-backed security—A financial security backed by a pool of mortgages; the issuer of such securities uses the cash flow from mortgage payments to fund interest payments on the security.

Multiple peril insurance—Personal or commercial property insurance that combines, in one policy, several types of property insurance covering numerous perils, including, for example, damage caused by flood, fire, or wind.

Personal lines—Property and casualty insurance for individuals, typically homeowners and automobile insurance.

Policyholders' surplus—The excess of an insurance company's assets above its legal obligations to meet its liabilities, i.e., the benefits payable to its policyholders.

Premium—The price a person or entity pays for insurance; an insurance company assumes the risks of people and entities in exchange for a premium payment.

Premiums written—Total premiums written by an insurer during a specified period of time.

Property and casualty insurance—Insurance covering a person or entity from damage to, or loss of, insured property, as well as legal liability for losses caused by injury to other people or damage/loss to property.

Reinsurance—Reinsurance, commonly referred to as insurance for insurance companies, is an insurance transaction in which one company (the assuming insurer, or reinsurer) indemnifies, for a premium, an insurance company (the ceding insurer) against all or part of the loss that it may sustain from its insurance policies.

Underwriting—The process of examining and accepting or rejecting insurance risks, and classifying accepted risks, in order to charge the proper premium for each.

Underwriting capacity—The maximum amount of insurance that an insurance company can underwrite.

Underwriting cycle—The tendency of P&C insurance markets to fluctuate between "hard" and "soft" market conditions. Soft markets are characterized by high levels of competition and falling premium prices, whereas hard markets are characterized by decreasing competition and rising premium prices.

Unearned premium—The portion of an annual premium received from a policyholder but not recognized as revenue, in accounting terms. For example, an up-front, annual premium of \$1,200 on a 1-year insurance policy would typically be placed in an unearned premium reserve, with revenue recognition occurring at a rate of \$100 per month for the 12-month policy term.

Source: Compiled by Commission staff from Rubin, *Dictionary of Insurance Terms*, 2008; and RAA, "RAA Fundamentals of Property Casualty Reinsurance," 2008.

CHAPTER 1

Introduction

Background and Purpose

Property and casualty (P&C) insurance is a critical component of economic infrastructure, promoting economic growth and stability principally through risk management. P&C insurers manage risk by assessing the likelihood and cost of losses, pricing premiums sufficiently to cover all or part of predicted losses, and risk pooling.¹ P&C insurers also provide economic incentives, in the form of lower premiums, to encourage policyholders to reduce their exposure to loss.²

Successful risk management yields significant economic benefits, such as mitigating the financial volatility that could follow large, noninsured losses; motivating investment in property and commercial activity with inherent risk; and facilitating commerce and trade through vehicles such as marine, aviation, and transport (MAT) insurance. The P&C insurance industry also promotes the efficient allocation of capital by gathering and assessing information in the underwriting process and extending insurance to (and perhaps investing in) commercial enterprises that are deemed to have a high likelihood of success.³

As background information for discussions of P&C insurance taking place in the World Trade Organization (WTO) and other trade fora, the Office of the United States Trade Representative (USTR) requested that the Commission prepare a report that (1) provides an overview of global and selected foreign markets for P&C insurance services, including factors affecting supply and demand in these markets; (2) examines the nature and extent of cross-border trade and affiliate sales in the global market for P&C insurance services; and (3) identifies and examines policies and practices that affect U.S. firms' access to, and competitiveness in, foreign markets for such services.⁴ The USTR further requested that the geographic scope of the report include examples from both developed- and developing-country markets.⁵

The majority of research and analysis conducted in connection with the USTR's request covers the situation in the P&C insurance industry through the end of 2007. In the second half of 2008 and into 2009, severe financial instability in many parts of the world impacted the financial services industry. This report briefly notes the impact of these events, although discussion is limited by their unfolding nature (box 2.1).

¹ Risk pooling is the collection of premiums from many policyholders to cover the insurable losses experienced by a few.

² For instance, insurers may offer discounts to homeowners who install fire alarms in their homes.

³ Skipper, "Foreign Insurers," 1997, 10-13; ABI, *Insurance Liberalization and the Model Schedule*, April 2003, 2-3.

⁴ The USTR requested this report pursuant to authority delegated by the President under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)). A copy of the request letter can be found in app. A.

⁵ Public notice of this investigation was posted by the Office of the Secretary, U.S. International Trade Commission, Washington, DC 20436, and published in the *Federal Register* (73 F.R. 48392). A copy of the *Federal Register* notice is included in app. B.

Scope

This report focuses on the P&C insurance industry, which supplies insurance that protects a person or business from damage to, or loss of, insured property, as well as legal liability caused by injury to other people or damage/loss to the property of others.⁶ P&C insurance is frequently divided into personal insurance (or personal lines), which covers individuals, and commercial insurance (or commercial lines), which covers businesses. Although personal lines consist primarily of automobile and homeowners insurance, a large number of additional insurance products are written as personal lines, including renters, condominium, flood, personal liability, travel, boat, and valuable items insurance. Commercial lines largely consist of automobile, multiple peril,⁷ and workers' compensation insurance, as well as insurance products protecting against legal liability resulting from negligence, carelessness, or failure to act. Like personal lines, the commercial insurance category includes a wide range of insurance products, including inland marine, fire, medical malpractice, farm owners' multiple peril/crop, and product liability insurance. It also includes a wide range of insurance products covering financial and business transactions, such as financial guaranty, mortgage guaranty, credit, and surety insurance. The information and analyses in this report cover both the personal and commercial segments of the P&C insurance market. Reinsurance, a related industry, is introduced in chapter 2 and discussed as it pertains to international trade in insurance services in chapter 3.

Approach and Organization

This report addresses the three elements of the USTR's request sequentially and provides both qualitative and quantitative analyses. Chapter 2 describes the global market and how P&C insurers operate, identifies supply and demand factors, and provides country profiles of the 10 largest developed and 10 largest developing P&C insurance markets. The market and macroeconomic data contained in these profiles are drawn principally from country reports published by AXCO Insurance Information Services, the Organization for Economic Cooperation and Development's (OECD) *Insurance Statistics Yearbook*, and the International Monetary Fund's (IMF) International Financial Statistics database.

Chapter 3 examines the nature of, and motivations behind, P&C insurance trade, and examines trends in cross-border trade through 2007 and sales by foreign-owned affiliates in host markets through 2006. Trade data are based on the *Survey of Current Business* published by the Bureau of Economic Analysis (BEA) and the OECD yearbook referenced above. Insurance experts in both private industry and academia were also consulted on certain trade data issues.

Chapter 4 identifies and analyzes policies and practices that affect U.S. firms' access to, and competitiveness in, foreign markets. In particular, the Commission analyzes nontariff measures (NTMs) that limit market access or place foreign service suppliers at a competitive disadvantage. To identify such measures, the Commission referred to the

⁶ Outside the United States, P&C insurance is commonly referred to as nonlife or general insurance.

⁷ Multiple peril insurance incorporates several different types of property insurance coverage, such as flood, fire, and wind. In its broadest application, the term is synonymous with all-risks insurance, which covers loss or damage to property from accidental circumstances not specifically excluded from coverage.

model schedule and best practices list developed by the Financial Leaders Working Group (FLWG).⁸ Divergences from industry-identified best practices are interpreted as NTMs. Chapter 4 also identifies countries that implement such NTMs and provides an Insurance Trade Restrictiveness Index (ITRI), a quantitative measure of the NTMs found in each country. The Commission uses econometric models incorporating the ITRI, as well as firm-level financial data and country-level market, macroeconomic, and institutional data, to estimate the effects such measures have on profit margins, as well as the potential effect of liberalization on U.S. exports and affiliate sales of P&C insurance.⁹ Chapter 4 also presents the results of a partial equilibrium analysis that measures the likely effect that the liberalization of foreign P&C insurance markets would have on employment in the U.S. P&C insurance industry.

In developing chapter 4, Commission staff conducted primary and secondary research. Primary research included interviews with insurance firms, trade associations, and academics in the United States, as well as extensive communications with U.S. Department of State and U.S. Foreign Commercial Service officials abroad, in-country industry representatives, and foreign government officials. The Commission held a public hearing at which all interested parties were invited to present testimony.¹⁰ Secondary research included a review of pertinent literature produced by the U.S. government, the insurance industry, multinational organizations, academics, and research consultancies, including country reports published by AXCO Insurance Information Services.¹¹ Firm-level financial data are from the Orbis Companies Database developed by Bureau van Dijk.

⁸ The Financial Leaders Group (FLG) and its working group, the FLWG, represent companies and industry associations in financial services, including banking, insurance, insurance intermediation, asset management, securities, and pensions. The FLWG's membership is drawn from companies and associations located in Australia, Canada, Hong Kong, Japan, Switzerland, and the United States, as well as EU member countries. FLWG, "Financial Leaders Group Calls Further Financial Services Liberalization Essential," February 10, 2006.

⁹ See apps. E and F for full details on the econometric models used in this report.

¹⁰ The public hearing was held on September 23, 2008, in Washington, DC. A list of hearing participants is included in appendix C and the hearing transcript, as well as written submissions submitted by interested parties in conjunction with this investigation, may be found at the Commission's Internet site (<http://www.usitc.gov>) under the dockets section.

¹¹ AXCO's Insurance Market Reports Database provides firm- and country-level data, as well as detailed information on regulation and supervision, for the insurance markets of 141 countries.

CHAPTER 2

Global Industry and Market

In 2007, the global market for P&C insurance,¹ measured in terms of total revenue, grew by 5 percent to approximately \$1.5 trillion.² Collectively, more than 90 percent of the global market was concentrated in three geographic regions: Europe (45 percent), North America (38 percent), and North Asia³ (9 percent).⁴ Slow growth in most developed countries contrasted with more rapid growth in many developing markets. Overall, P&C premiums in developed countries registered flat or declining growth rates, due in large part to market maturity and high levels of competition. Although financial market turmoil affected investment and commercial banking much more heavily in 2008, the P&C insurance industry was also affected. In addition to serious financial problems at American International Group (AIG), one of the world's largest P&C insurers, the P&C insurance industry was also affected by the declining value of investment holdings, particularly asset classes favored by P&C insurers such as equities, corporate bonds, and tax-exempt securities (box 2.1).⁵

In 2007, commercial lines and personal lines accounted for 30 percent and 70 percent, respectively, of the global market. Personal lines represent the dominant share of global premiums largely because individual consumers, the single largest customer group, typically maintain both private passenger automobile insurance and some form of home/contents insurance. Private passenger automobile insurance represents the single largest product segment of the global P&C insurance industry, accounting for approximately 50 percent of global premiums. The large and growing fleet of privately owned automobiles worldwide, and regulations requiring some form of automobile insurance in most countries, largely account for the dominance of the automobile insurance segment.⁶ Other important product segments include fire, allied, and multiple peril insurance (20 percent) and workers' compensation insurance (6 percent).

¹ The P&C insurance industry comprises establishments primarily engaged in the initial underwriting of various types of insurance policies referred to as P&C insurance or general insurance; establishments engaged in underwriting mortgages and other real estate transactions are also included. Life, disability income, accidental death and dismemberment, and health and medical insurance policies are not included in this industry definition. IBISWorld, *Global Direct General Insurance Carriers*, September 30, 2008, 3.

² Total revenue comprises both gross premiums and net investment income.

³ North Asia comprises Japan, China, and Korea.

⁴ IBISWorld, *Global Direct General Insurance Carriers*, January 27, 2009, 3, 11–12.

⁵ Fitch Ratings, "Review and Outlook 2008–2009," December 18, 2008, 1–3.

⁶ By contrast, commercial automobile insurance accounted for 6 percent of global premiums. IBISWorld, *Global Direct General Insurance Carriers*, September 30, 2008, 8–10.

BOX 2.1 Effects of the 2008 Financial Crisis on the Insurance Industry**Introduction**

In the second half of 2008 and into 2009, severe instability in global financial markets impacted financial services firms around the world, particularly commercial and investment banks. With the exception of select insurance firms dealing in mortgage-related securities, however, the property and casualty (P&C) insurance industry is one of the healthier subsectors of the financial services industry.³ Thus far, the financial crisis has mainly impacted P&C insurance companies through their investment portfolios, which have experienced negative returns due to global financial market turmoil.⁴

The U.S. P&C Insurance Industry: Financial Results in 2008

In the first nine-months of 2008, U.S. P&C insurers' net income fell by 92 percent to \$4.1 billion, compared to \$49.4 billion in the first nine months of 2007.⁵ This large decline in net income is largely attributable to two main factors: a decline in underwriting income resulting from large catastrophe losses and decreasing investment income due to financial market turmoil. In the first nine months of 2008, catastrophe losses stemming from Hurricanes Gustav and Ike, among more than 30 other serious weather events, totaled approximately \$24.9 billion. These storm losses, comprising approximately 2.5 million claims, were the primary factor behind a \$19.9 billion underwriting loss recorded by the U.S. P&C insurance industry during this period.⁶ Turmoil in global financial markets, particularly equity and fixed income markets, also took a toll on U.S. P&C insurers' investment portfolios. Overall, net investment income declined by approximately 4 percent in the first nine months of 2008 to \$38 billion.⁷

American International Group

In September 2008, American International Group (AIG), the United States' second largest P&C insurance company, based on 2007 written premiums, was saved from financial collapse by U.S. government intervention. The source of AIG's financial instability was not its core insurance operations, which even now are fundamentally sound,⁸ but instead the issuance of credit default swaps (CDSs),⁹ a type of credit insurance, by its London-based derivatives trading business, AIG Financial Products (AIG FP).¹⁰ Attracted by high profit margins, AIG FP became one of the largest sellers of CDSs, developing a portfolio of such securities with a notional value of approximately \$446 billion by the second quarter of 2008.¹¹ Buyers of such securities were attracted to AIG FP's offer to post generous collateral if the value of insured securities dropped, or if AIG's own credit rating fell.¹² In 2007 and 2008, the deterioration of the U.S. residential mortgage market, and subsequent problems in broader capital and credit markets, resulted in heavy losses to AIG FP's CDS portfolio. AIG FP, for example, lost more than \$10 billion in 2007 and \$14.7 billion in the first half of 2008.¹³ The deterioration of AIG FP's CDS portfolio required it to post large amounts of collateral, activities which cut deeply into its capital reserves. In May 2008, AIG attempted to replenish its capital position by raising approximately \$20 billion.¹⁴ However, continuing deterioration of financial markets, in general, and AIG's financial position, in particular, caused several ratings agencies to downgrade AIG's credit ratings in September 2008, actions which required AIG FP to post an additional \$14.5 billion in collateral to its CDS clients.¹⁵ Unable to post such collateral, or raise additional capital, AIG was forced to accept an \$85 billion line of credit from the U.S. Federal Reserve in order to prevent bankruptcy.¹⁶ By March 2009, the U.S. government had provided capital totaling approximately \$170 billion to AIG.¹⁷

³Standard & Poor's, *Insurance: Property-Casualty*, January 29, 2009, 1.

⁴Ibid.

⁵Standard & Poor's, *Insurance: Property-Casualty*, January 29, 2009, 2.

⁶Ibid.

⁷Ibid.

⁸IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 32.

⁹Ibid. A credit default swap (CDS) is a type of derivative security that is akin to credit insurance in that it provides protection against default on assets tied to debt and mortgage securities. However, since CDS products were traded "over the counter" and, as such, were largely unregulated, issuers were not required to meet capital adequacy requirements.

¹⁰IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 32.

¹¹Sender, "AIG Saga Shows How Dangerous Credit Default Swaps Can Be," March 9, 2007; IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 32.

¹²Sender, "AIG Saga Shows How Dangerous Credit Default Swaps Can Be," March 9, 2007.

¹³IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 32.

¹⁴Standard & Poor's, *Insurance: Property-Casualty*, January 29, 2009, 4.

¹⁵IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 32.

¹⁶Barr, "Congress Wants AIG Answer," March 4, 2009; Standard & Poor's, *Insurance: Property-Casualty*, January 29, 2009, 4; and IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 32.

¹⁷*Economist*, "Sound and Fury Over AIG," March 17, 2009.

BOX 2.1 Effects of the 2008 Financial Crisis on the Insurance Industry—Continued**P&C Monoline Insurance Companies**

Monoline insurers are companies that provide insurance for only one type of risk, such as the risk of a bond or other security defaulting.² Monoline insurers focused on asset-backed securities (ABS) account for the greatest share of losses due to their activities in mortgage and financial guaranty insurance.³ The two largest monoline insurers in this area, AMBAC and MBIA, collectively account for approximately 50 percent of the \$2.5 trillion industry.⁴ Both AMBAC and MBIA announced multi-billion dollar losses in 2008 principally due to their ABS portfolios.⁵

Wider Effects on the P&C Insurance Industry

Unlike banks, most P&C insurance companies were not involved in originating mortgage loans and investing in the mortgage-related derivatives that impacted the financial system.⁶ Moreover, those insurers that did invest in mortgage-related securities only placed a small portion of total assets in such instruments. As a result, most P&C insurance companies are expected to escape the worst effects of the global financial crisis. One exception may be P&C insurance companies with banking subsidiaries, such as Swiss Re and Allianz.

²Oxford Analytica, "International: Monoline 'Solutions' Bring New Risks," March 6, 2008; and Oxro4d Analytica, "International: Monoline Downgrades Put System at Risk," January 31, 2008.

³*Insurance Journal*, "P/C Insurers' Net Income, Profitability Fall Sharply in First-Half 2008," October 1, 2008; Oxford Analytica, "International: Monoline 'Solutions' Brings New Risks," March 6, 2008; Oxford Analytica, "International: Monoline Downgrades Put System at Risk," January 31, 2008.

⁴Oxford Analytica, "International: Monoline 'Solutions' Bring New Risks," March 6, 2008; Oxford Analytica, "International: Monoline Downgrades Put System at Risk," January 31, 2008.

⁵Ambac, "Ambac Financial Group," November 5, 2008; MBIA, "MBIA Inc. Provides Financial Update," November 5, 2008.

⁶Willis, "Impact of the Credit Crisis," October 20, 2008. In general, insurance companies are not as highly leveraged as many other financial services companies; insurance companies also tend to hold smaller proportions of CDSs and other types of risky assets.

In 2007, the P&C insurance markets of most developed countries experienced declining trends in both premium volume and rates. In most countries, the contraction occurred across all product lines, with the exception of several developed Asian countries that experienced buoyant premium growth resulting from strong economic performance.⁷ By contrast, P&C insurance premiums in developing markets experienced growth across all production lines, due largely to strong economic growth, increasing incomes, compulsory lines requirements, and a growing awareness of risk mitigation techniques.⁸

The world's largest P&C insurance companies, measured by total revenues, tend to be located in North America and Europe. At the global level, the P&C insurance industry exhibits a low level of industry concentration, although concentration varies by region, country, and product line. Overall, the top four P&C insurance firms account for 14 percent of the global market, with no individual firm estimated to hold more than 5 percent of the total.⁹ In 2006, global employment in the P&C insurance industry totaled approximately 1.6 million people, with the United States accounting for approximately 39 percent of this total (625,000 people).¹⁰

Although large corporations tend to possess the financial resources and technical expertise necessary to navigate the markets and regulatory regimes of multiple countries, only a few such firms maintain extensive international operations. Indeed, international trade in insurance services, whether conducted via cross-border trade or through foreign subsidiaries, is conducted by a small, often specialized, subset of the global P&C insurance industry. Such firms include ACE Limited (Switzerland), AIG (United States), Allianz SE (Germany), Assicurazioni Generali (Italy), The AXA Group (France), The Chubb Corporation (United States), and Zurich Financial Services (Switzerland). Lloyd's of London (United Kingdom) is also a major provider of P&C insurance worldwide (box 2.2). Most U.S. P&C insurance companies, including large, well-known firms like Allstate, The Hartford Group, and State Farm, either do not sell P&C insurance outside the United States, or limit their international exposure to Canada and Mexico.

⁷ Swiss Re, "World Insurance in 2007," 2008, 14.

⁸ *Ibid.*, 20.

⁹ IBISWorld, *Global Direct General Insurance Carriers*, September 30, 2008, 10–11.

¹⁰ IBISWorld, *Global Direct General Insurance Carriers*, January 21, 2009, 5, and IBISWorld, *Auto & Other Direct Insurance Carriers*, November 19, 2008, 5.

BOX 2.2 Lloyd's of London

Unlike most well-known brands in the insurance business, Lloyd's of London (Lloyd's) is not a company. Instead, Lloyd's is a society of members that work together to provide property and casualty insurance and reinsurance services. Lloyd's specializes in underwriting complex, specialized risks that are either very large or hard to price including, for example, oil rigs, bridges, wind farms, airlines, space vehicles, and sporting events. Founded in a coffee house in London, England, in 1688, Lloyd's now operates in more than 200 countries and territories worldwide.

As of May 1, 2008, Lloyd's comprised 80 syndicates and 51 managing agents. Members, who provide the capital behind Lloyd's policies, comprise both corporations/limited partnerships and individuals. Members typically underwrite insurance policies in syndicates, which are managed on a day-to-day basis by managing agents.⁸ Under such arrangements, members insure a portion of the total underwritten loss, and are not responsible for the losses of other syndicate members. Several U.S. firms operate in the Lloyd's market, including Liberty Syndicates, which is backed by U.S.-based Liberty Mutual Group.⁹

In a typical transaction, Lloyd's insurance brokers negotiate competitive terms and conditions on behalf of clients with several syndicates, hoping to find one that will insure a specific risk. In situations involving very large risks, more than one syndicate may be involved. Lloyd's syndicates, which frequently compete with each other for insurance business, employ specialist underwriters to price and assess specialized risks, as well as process claims following loss events.

Source: Lloyd's, "The Lloyd's Market," undated (accessed January 26, 2009).

⁸A managing agent is a company established for the sole purpose of providing management and other services to a syndicate. Managing agents, which may provide services to more than one syndicate, provide the business structure behind a syndicate and employ specialist underwriters and support staff.

⁹Liberty Syndicates Web site. <http://www.libertysyndicates.com> (accessed March 12, 2009).

Insurance Market Profiles

In 2006, premium growth rates for P&C insurance varied widely between developed and developing countries.¹¹ Most developed-country markets exhibited mid-to-low single-digit growth rates, or in some cases, negative growth rates, ranging from -6 percent in Japan to 7 percent in Spain (table 2.1). The exception in this category was Korea, with a growth rate of 23 percent. Overall, the average premium growth rate for the developed countries was less than 3 percent in 2006, significantly below the average annual growth rate of 10 percent recorded from 2002 through 2006.¹² By contrast, total P&C insurance premiums grew rapidly in developing countries, ranging from 8 percent in Mexico, Poland, and South Africa to 35 percent in Venezuela (table 2.2). The average growth rate for premiums in this group was 19 percent in 2006, consistent with the average annual growth rate of approximately 19 percent from 2002 through 2006.¹³

¹¹ The classification is derived from the World Bank's "Country Classifications," undated (accessed January 12, 2009). The World Bank classifies countries into low-income, lower-middle-income, upper-middle-income, and high-income categories. Developed economies in this report refer to the high-income category and developing economies consist of low-income, lower-middle-income, and upper-middle-income groups. Throughout this section, references to developed countries will include the countries in table 2.1, and references to developing countries will include the countries in table 2.2.

¹² Average based on 44 observations due to missing growth observations in 2002; growth in Italy available from 2004.

¹³ Average based on 42 observations because only Mexico and Venezuela reported growth rates in 2002.

TABLE 2.1 Insurance market profiles, top developed-country markets for P&C insurance, 2006^a

Country	Total P&C premiums (millions of \$) ^b	Growth over previous year, total P&C premiums ^c (%)	P&C insurance density ^d (\$/capita)	P&C insurance market penetration ^e (% of GDP)	Foreign market share ^f (% of P&C insurance market)	Number of firms	Industry concentration ^g
Australia	17,890	2	863	2.4	26	102	67
Canada ^{h, i}	30,431	-1	1,061	2.4	38	194	56
France ^e	53,695	0	875	2.4	n/a	1,053	69
Germany	61,031	0	742	2.1	8	227	48
Italy ^j	40,024	3	685	2.2	26	126	59
Japan ^{i, k, m}	67,962	-6	532	1.6	6	42	97
Korea ^l	29,642	23	614	3.3	3	97	94
Spain ^l	30,150	7	684	2.4	20	298	44
United Kingdom	69,464	-3	1,148	2.9	45	788	69
United States	484,742	3	1,621	3.7	11	2,343	45

Sources: Total premiums and premium growth: AXCO, Inc., "Statistics: Non-Life Market Totals," undated (accessed September 17, 2008). Population and GDP: IMF, World Economic Outlook Database (accessed October 15, 2008). Foreign market share: OECD, *Insurance Statistics Yearbook 1997–2006*, 2008. Number of firms and industry concentration: AXCO, Inc., "Market Participants: Summary and Trends," undated (accessed November 3, 2008); AXCO, Inc., "Market Participants: Market Concentration," undated (accessed November 20, 2008); and AXCO, Inc., "Appendix 2: Company Statistics," undated (accessed October 10, 2008).

^aSome data are not available for 2006 and will reflect the last year available. Differences are noted where appropriate.

^bData exclude personal accident and healthcare insurance.

^cPercent growth of total P&C premiums during 2006.

^dDensity is defined as P&C premiums per capita. Calculated by Commission staff (P&C premiums in millions of U.S. dollars as reported by AXCO; population in millions as reported by the IMF).

^eMarket penetration is defined as P&C premiums as a share of gross domestic product (GDP). Calculated by Commission staff (P&C nominal premiums in millions of U.S. dollars as reported by AXCO; nominal GDP converted from billions as reported by the IMF).

^fData refer to market share of foreign-controlled companies in the domestic P&C insurance market, OECD Table 23. Unavailable data denoted where appropriate.

^gIndustry concentration defined as market share of written premiums by top 10 insurers (foreign and domestic) for latest available year as reported by AXCO, Inc., "Market Participants: Market Concentration." Data for Australia and Korea calculated by Commission staff from AXCO, Inc., "Appendix 2: Company Statistics."

^hThe number of firms in Canada exceeds 300 if provincially licensed firms are included. See AXCO, Inc., "Market Participants: Market Concentration."

ⁱUnclear to which year data on number of firms correspond in Canada and Korea.

^jFigures for number of firms refer to 2007 in France, Italy, and Japan.

^kWith respect to the number of firms in Japan, AXCO also reports "there were also 59 co-operative insurance carriers operating under sector-specific laws and 389 unregulated co-operatives." See AXCO, Inc., "Market Participants: Market Concentration".

^lFigures for the number of firms in Spain refer to life and nonlife market combined.

^mData on industry concentration in Japan refer to 2005.

TABLE 2.2 Insurance market profiles, top developing-country markets for P&C insurance, 2006^a

Country	Total P&C premiums ^b (millions of \$)	Growth over previous year, total P&C premiums ^c (%)	P&C insurance density ^d (\$/capita)	P&C insurance market penetration ^e (% of GDP)	Foreign market share ^f (% of P&C insurance market)	Number of firms	Industry concentration ^g
Argentina ^{h,i}	3376	20	87	1.6	n/a	103	47
Brazil ^k	11,626	26	62	1.1	n/a	70	63
China ⁱ	18,941	26	14	0.7	n/a	39	90
India ^l	4,494	13	4	0.5	n/a	12	95
Mexico ^{i,m}	6,435	8	62	0.7	n/a	94	78
Poland ^{h,n}	4,807	8	126	1.4	40	33	87
Russia ^m	11,331	25	79	1.1	n/a	918	38
South Africa ^o	5,333	8	113	2.1	n/a	359	80
Turkey ⁿ	4,792	23	70	0.9	17	29	77
Venezuela ^m	2,539	35	94	1.4	n/a	49	71

Sources: Total premiums and premium growth: AXCO, Inc., "Statistics: Non-Life Market Totals," undated (accessed October 15, 2008). Population and GDP: IMF, World Economic Outlook Database (accessed October 15, 2008). Foreign market share: OECD, *Insurance Statistics Yearbook 1997-2006*, 2008. Number of firms and industry concentration: AXCO, Inc., "Market Participants: Summary and Trends," undated (accessed December 10, 2008); AXCO, Inc., "Market Participants: Market Concentration," undated (accessed November 20, 2008); and "Appendix 2: Company Statistics," undated (accessed November 20, 2008).

^aSome data are not available for 2006 and will reflect the last year available. Differences are noted where appropriate.

^bData exclude personal accident and healthcare insurance.

^cPercent growth of total nonlife premiums during 2006.

^dDensity is defined as P&C premiums per capita. Calculated by Commission staff (P&C premiums in millions of U.S. dollars as reported by AXCO; population in millions as reported by the IMF).

^eMarket penetration is defined as P&C premiums as a share of gross domestic product (GDP). Calculated by Commission staff (P&C nominal premiums in millions of U.S. dollars as reported by AXCO; nominal GDP converted from billions as reported by the IMF).

^fData refer to the market share of foreign companies in the domestic P&C insurance market reported in OECD Table 23. Only data for Poland and Turkey are available.

^gIndustry concentration defined as market share of written premiums by top 10 insurers (foreign and domestic) as reported by AXCO, Inc., "Market Participants: Summary and Trends." Data for China, South Africa, and Venezuela calculated by Commission staff from AXCO, Inc., "Appendix 2: Company Statistics."

^hFigure for foreign market share in Poland refers to 2004.

ⁱFigure for the number of firms in Argentina includes companies that write life and workers' compensation.

^jFigures for the number of firms in Argentina, China, and Mexico refer to 2007.

^kAccording to AXCO, taking into account multiple holdings, there were about 70 active insurance companies in Brazil at the end of 2006.

^lUnclear to which year data on number of firms in India refer. As of 2008, there were "an estimated 20 non-life insurers, both public sector and private, that are registered to do business in India." AXCO, Inc., "Market Participants: Summary and Trends," undated (accessed December 10, 2008).

^mUnclear if data on number of firms in Mexico, Russia, and Venezuela refer to nonlife and life combined.

ⁿFigures for the number of firms in Poland and Turkey refer to 2008.

^oData on number of firms represent 102 short-term insurance companies registered in South Africa in December 2005, 7 major financial conglomerates that include short- and long-term insurers, and 250 underwriting managers (figure estimated by AXCO) that have agreements with short-term insurers or Lloyd's underwriters to underwrite a particular line of business. These underwriting managers are often partially or fully owned by the insurer, but work as independent organizations.

For the most part, there was a high degree of similarity in the type of insurance products sold in all insurance markets. Across developed and developing countries, the most commonly purchased type of P&C insurance in 2006 was automobile insurance, reflecting the influence of compulsory insurance regulations.¹⁴ Despite considerable variability in the share of total P&C insurance accounted for by automobile insurance in 2006,¹⁵ it constituted the largest share of the P&C insurance market in all countries, with the exception of Russia.¹⁶ Property insurance of some type represented the second-largest share of the P&C insurance market in most countries, accounting for approximately 25 percent of the market.¹⁷ The third-largest line of insurance in developed countries was liability insurance, with an average share of 10 percent in 2006. By contrast, the third-largest line in developing countries varied widely, and included not only liability insurance, but also marine, aviation, and transport insurance; surety, bonds, and credit insurance; construction and engineering insurance; and workers' compensation and employers' liability insurance. In general, liability insurance usage reflects the nature of a country's legal system, with demand for such insurance increasing with enforcement of legal rights and the general level of litigiousness.¹⁸

The share of the P&C insurance market accounted for by foreign firms varies widely among countries. In developed countries, foreign market share¹⁹ in 2006 ranged from 6 percent in Japan to 45 percent in the United Kingdom; in developing countries data were available only for Turkey (17 percent) and Poland²⁰ (40 percent). In general, foreign market share estimates above 60 percent are characteristic of small transition economies, such as the Czech Republic, Slovakia, and Hungary.²¹ Although there is no clear explanation for foreign market share variation, one industry representative indicates that foreign market share is affected in large part by the restrictiveness of local regulations.²²

In most of the countries analyzed, P&C insurance services were supplied by a relatively large number of firms,²³ typically ranging from several dozen to several hundred.²⁴ By contrast, 2,300 P&C insurance companies maintained operations in the United States. Industry concentration, measured as the market share of the 10 largest firms, varied across country markets; it ranged from 44 percent in Spain to 97 percent in Japan (2005) in our sample of developed countries, and from 38 percent in Russia to 95 percent in India²⁵ in our sample of developing countries.

Insurance density, defined as total premiums per capita, measures the breadth of the insurance market. In 2006, the average insurance density for developed countries was

¹⁴ AXCO, Inc. "Compulsory Insurances," undated (accessed October 28, 2008).

¹⁵ AXCO, Inc. "Statistics: Non-Life Market Totals," undated (accessed September 17, 2008, and October 28, 2008).

¹⁶ Automobile insurance represented 21 percent of Russia's total P&C insurance market; property accounted for 74 percent.

¹⁷ In our sample of developed countries, Korea was the outlier with property accounting for only 4 percent of total P&C insurance. In our sample of developing countries, Russia was the outlier, with property constituting the largest share of total P&C insurance.

¹⁸ Industry official, interview by Commission staff, December 2, 2008.

¹⁹ Data refer to market share of foreign companies in the domestic market (nongovernment-owned). OECD, *Insurance Statistics Yearbook 1997-2006*, 2008.

²⁰ Polish figure refers to 2004.

²¹ OECD, *Insurance Statistics Yearbook 1997-2006*, 2008.

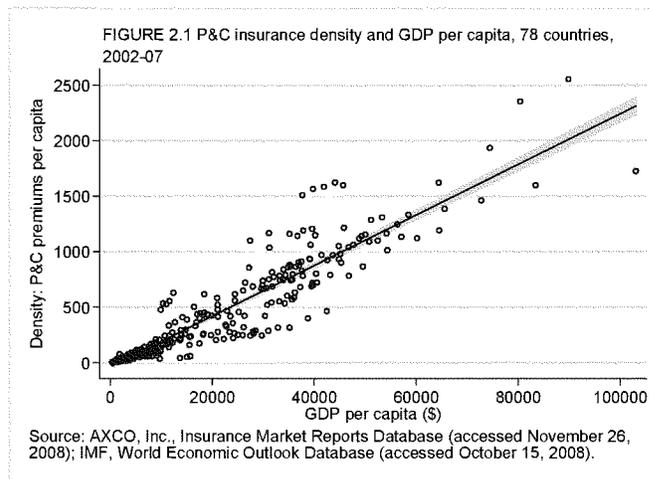
²² Industry official, interview by Commission staff, Philadelphia, PA, December 5, 2008.

²³ Hartwig, Insurance Information Institute, Written submission to the USITC, October 2, 2008, 3.

²⁴ Most data on the number of firms are 2006 data. For some countries, data were only available for 2005, 2007, or 2008. See tables 2.1 and 2.2 for more detail.

²⁵ Until recently, the insurance industry in India was a government-owned monopoly.

\$882, compared with \$71 for developing countries.²⁶ Insurance penetration, or total P&C insurance premiums as a percentage of national gross domestic product (GDP), measures the growth potential of insurance markets.²⁷ Insurance penetration in developed countries averaged 3 percent, compared to an average of 1 percent in developing countries.²⁸ Given that the level of wealth likely stimulates demand for insurance services, it is not surprising that the developed countries exhibit higher insurance density and market penetration. In general, too, the development of the P&C insurance market promotes economic growth. For a sample of 78 countries, the level of per capita income was positively related to both insurance penetration and insurance density from 2002 through 2007 (figures 2.1 and 2.2), indicating that, as income rises, individual consumers and business customers devote additional resources to mitigating risk through the purchase of insurance products.²⁹

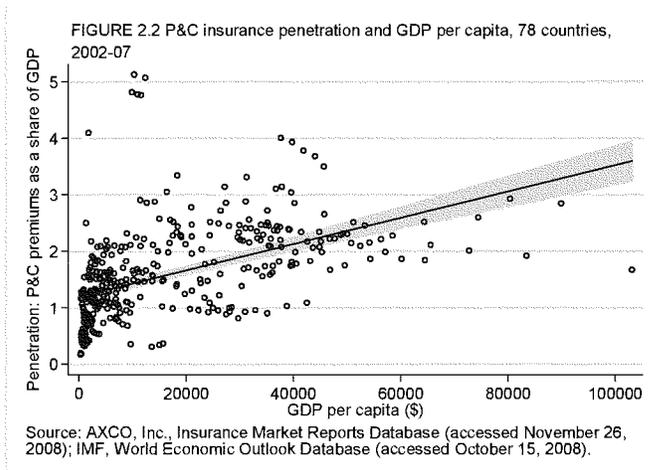


²⁶ For the same year, mean density was \$367 per capita for a sample of 78 countries (refer to app. D for a list of countries).

²⁷ Hartwig, Insurance Information Institute, Written submission to the USITC, October 2, 2008, 7.

²⁸ For the same year, mean penetration was 1.6 for the expanded 78-country sample.

²⁹ The scatter plots displayed in figures 2.1 and 2.2 contain data pertaining to income per capita, insurance density, and insurance penetration for 78 countries from 2002 through 2007 (a total of 388 observations in each figure). A regression line through each scatter plot shows a positive relationship, with regression coefficients significant at all levels of confidence. The shaded area around the line indicates the confidence interval. See app. D for more details.



The Property and Casualty Insurance Industry

How Property and Casualty Insurance Firms Operate

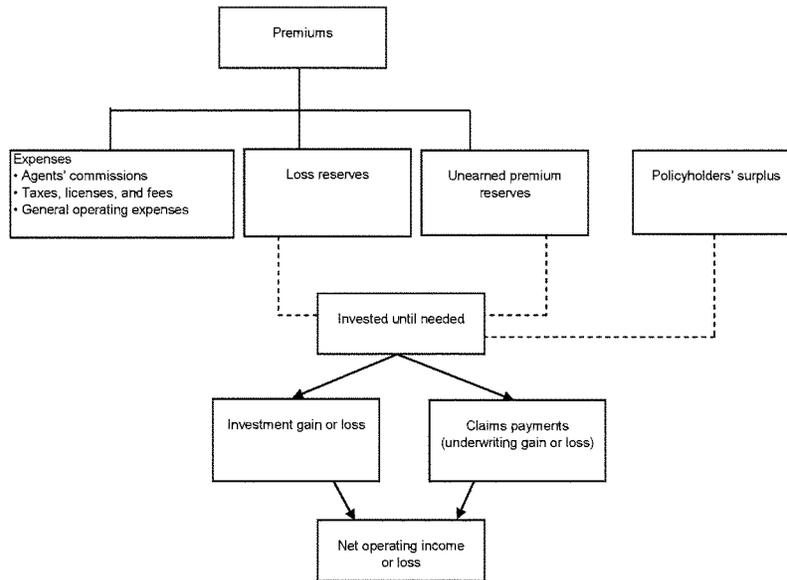
The P&C insurance industry operates in essentially the same way worldwide, although differences do exist between countries and regions. In essence, insurance enables individuals and entities to share the burden of unexpected losses associated with damage or destruction to property or incurred liability. Specifically, P&C insurance companies collect payments, known as premiums, from insurance policyholders that face similar risks, including, for example, automobile accidents and house fires. Such premiums are pooled together by the insurance company, with payments made from the pool to individuals and entities that experience losses. Although some participants do not suffer losses or receive payments from the pool associated with such losses, they still benefit from this risk-sharing arrangement by avoiding the risk of large-scale financial loss.³⁰

Following underwriting and policy issuance, P&C insurance companies collect premium payments from customers (figure 2.3). Upon receipt, premium payments are placed in an unearned premium reserve. Such funds are then “earned,” or recognized as revenue, over the policy’s term, typically on a monthly basis.³¹ Like all companies, P&C insurers use

³⁰ Standard & Poor’s, *Insurance: Property-Casualty, Europe*, September 2007, 18.

³¹ For example, an upfront premium payment of \$1,200 on a one-year insurance policy would typically be placed into an unearned premium reserve, with revenue recognition occurring at a rate of \$100 per month for the 12-month term. Standard & Poor’s, *Insurance: Property-Casualty*, July 10, 2008, 11; Standard & Poor’s, *Insurance: Property-Casualty, Asia*, February 2007, 19; and Standard & Poor’s, *Insurance: Property-Casualty: Europe*, September 2007, 16.

FIGURE 2.3 Flow of funds through P&C insurance firms



Source: Compiled by Commission staff using sources from Standard & Poor's and the American Insurance Association.

revenues to pay a wide variety of expenses, with the single largest expense being losses, otherwise known as policyholder claims. Other expenses include agent/broker commissions, workforce salaries, claims-related expenses such as litigation fees and insurance adjusters' fees, and general overhead expenses. P&C insurance companies are also required to set aside funds to cover claims, referred to as loss reserves. Overall, the underwriting portion of a company's profit (or loss) is determined by subtracting such expenses from total premiums.³² Due to highly competitive conditions in many countries, which restrict insurers' ability to raise prices, P&C insurance companies tend to set premium prices at levels that closely match premium revenues with expected loss payouts. Due to the complexity of accurately estimating loss payouts, however, the underwriting operations of many insurance companies often experience losses. In the United States, for example, P&C insurance companies recorded an underwriting profit in only two years during the period 1980–2006.³³

³² Standard & Poor's, *Insurance: Property-Casualty*, July 10, 1008, 11.

³³ AIA, "Insurance 201: Property-Casualty Finance," September 7, 2006, 3.

The total profitability of P&C insurers, however, comprises not only the performance of the underwriting segment of the business, but also gains/losses³⁴ on invested loss reserves, unearned premium reserves, and policyholders' surplus.³⁵ In general, P&C insurance companies around the world invest their reserves in low-risk, high-quality investment vehicles, particularly government and high-grade corporate bonds, with the intention of deriving investment income/gains, although the share of reserves invested in such assets varies by country.³⁶ In the United States, for example, bonds accounted for nearly 67 percent of insurance companies' reserve investments in 2006.³⁷ By contrast, European insurance companies tend to place a larger share of their reserves in equities, a practice that exposes them to greater losses than their U.S. counterparts during falling stock markets.³⁸ In Asia, some governments have established rigid regulations specifying how P&C insurance companies are allowed to invest reserves. In general, Asia's more developed economies, including Japan, Hong Kong, and Korea, are characterized by more liberal investment regimes that give insurers wide latitude to set investment strategy. By contrast, the investment regimes of developing economies like China, India, Indonesia, Malaysia, Thailand, and Vietnam tend to restrict insurers' investment choices.³⁹

P&C insurance firms expend a great deal of resources on calculating premium prices and reserve holdings. Both activities have an important bearing not only on a firm's profitability, but also its competitive position within the industry. Unlike most products and services, premium prices must be established before the actual cost of providing loss coverage is known. As a result, premium prices are largely determined by complex, actuarial calculations that attempt to estimate the frequency and severity of future losses, with premium rates rising and falling in response to the anticipated cost of such losses.⁴⁰ Competitive conditions and anticipated investment returns also may play a role in the process of setting premium rates. During periods of high investment returns, for example, insurers may choose to lower premium prices in an effort to gain market share, relying on investment income for overall profitability. Conversely, in periods of low or declining

³⁴ Investment gains or losses on an insurance company's investment portfolio include interest income on bonds held in the portfolio, dividends on stocks held in the portfolio, and capital gains/losses derived from the sale of securities held in the portfolio. AIA, "Insurance 201: Property-Casualty Finance," September 7, 2006, 3; Standard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 11.

³⁵ Policyholder surplus is the excess of an insurance company's assets over its liabilities, defined as its legal obligations to meet the benefits payable to its policy holders. Rubin, *Dictionary of Insurance Terms*, 2008, 384. Policyholder surplus tends to vary with a firm's overall profitability. During profitable years, management may place additional funds in the policyholders' surplus, while in loss-making years, management may use funds from the policyholders' surplus to pay claims and/or other expenses. AIA, "Insurance 201: Property-Casualty Finance," September 7, 2006, 3; Standard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 13, 16.

³⁶ Since many property losses are often settled in a relatively short timeframe, P&C insurance companies tend to invest the majority of their reserves in highly liquid securities that can be quickly converted to cash. Standard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 11; and AIA, "Insurance 201: Property-Casualty Finance," September 7, 2006, 2.

³⁷ Insurance Information Institute, *The III Insurance Factbook 2008*, 2008, 37. In 2006, U.S. insurance companies placed the remainder of such reserves in common stock (18 percent), cash and short-term investments (8 percent), and other investments (7 percent).

³⁸ Standard & Poor's, *Insurance: Property-Casualty; Europe*, September 2007, 18.

³⁹ Standard & Poor's, *Insurance: Property-Casualty; Asia*, February 2007, 22.

⁴⁰ Actuarial calculations are based on historic loss data and statistics, such as demographic data that pertain to a particular group of policyholders. When underwriting automobile insurance policies, for example, insurers use historic data on automobile accident rates, repair costs, and many other factors to calculate premium rates for individual customers. AIA, "Insurance 201: Property-Casualty Finance," September 7, 2006, 1.

investment returns, insurance companies may be unable to lower premium prices, or may even raise prices, to avoid the possibility of net losses.⁴¹

The P&C insurance market is subject to cycles that fluctuate between “soft” and “hard” market conditions. Soft market conditions are characterized by high levels of competition, decreasing prices, and declining underwriting standards as companies compete for market share. Such conditions, however, typically lead to reduced profitability and increased claims, which, in turn, lead to underwriting losses and declining underwriting capacity. As a result, insurance companies typically react by introducing stricter underwriting standards, setting the stage for hard market conditions. In hard markets, insurance companies limit the supply of insurance and raise prices, leading to high levels of profitability. However, high profits attract capital into the industry, raising underwriting capacity and leading to increased competition, with such competition setting the stage for a return to soft market conditions.⁴² Although such underwriting cycles tend to affect the global P&C insurance industry, conditions vary by individual country and/or product line segments. Overall, the global P&C insurance market experienced hard market conditions from 2003 through 2007, transitioning to soft market conditions in 2008.⁴³

P&C insurance firms also use actuarial methods to calculate the size of their loss reserves, with miscalculation posing serious risks to a firm’s profitability and competitiveness. For example, a firm that sets reserves higher than necessary runs the risk of reducing its profitability, forcing it to raise premium rates. By contrast, setting reserves too low may inflate profits, leading the firm to inappropriately lower its rates. Setting reserves lower than necessary may also create a situation in which an insurance company does not have sufficient loss reserves to cover higher than expected claims. However, establishing an optimal level of reserves is extremely difficult due to the uncertainty surrounding estimations of future losses. In addition to the unpredictability of natural disasters, forecasts are subject to many other variables, including real economic growth, inflation, interest rates, and sociopolitical trends.⁴⁴

Globally, insurance is distributed to customers via several methods. In many parts of the world, particularly in North America and Europe, personal lines are distributed to customers through insurance agents. Such agents either work for a particular company, usually as part of a network, or independently, selling policies for multiple firms. In some countries, personal lines are distributed to customers via bank and/or postal centers, a method of distributing insurance products known as bancassurance. Although bancassurance methods are used in Europe, such methods are particularly prevalent in Asian countries. P&C insurance companies also increasingly use direct sales techniques to distribute personal lines, including Internet, telephone, and direct mail methods. By contrast, commercial lines tend to be sold through brokers, that are employed by businesses and other organized entities to identify insurance policies that meet the specific needs of each organization. Brokered deals are particularly common in the United States, United Kingdom, Australia, and Canada, accounting for as much as

⁴¹ Standard & Poor’s, *Insurance: Property-Casualty: Asia*, February 2007, 20.

⁴² Rubin, *Dictionary of Insurance Terms*, 2008, 536; Hartwig, Insurance Information Institute, Written submission to the USITC, October 2, 2008, 6.

⁴³ Industry official, interview by Commission staff, Philadelphia, PA, December 5, 2008; Fitch Ratings, “The Property/Casualty Underwriting Cycle,” April 14, 2008, 1–3.

⁴⁴ Standard & Poor’s, *Insurance: Property-Casualty*, July 10, 2008, 14; Standard & Poor’s, *Insurance: Property-Casualty: Europe*, September 2007, 16–17.

80 percent of commercial lines sales in these countries. In Asia, however, brokered deals are less common.⁴⁵

Supply and Demand Factors

A wide range of factors affect P&C insurance companies' willingness to supply insurance in global markets as well as consumers' decisions to purchase insurance. Supply factors include NTMs, input costs, and government regulations requiring the approval of new types of insurance. Demand factors include economic and demographic factors, mandatory government requirements for coverage, and the likelihood of catastrophic events. Some factors may affect both supply and demand decisions, such as the number of insurers operating in a given market, institutional and business climate factors, and price regulation.

Supply Factors

According to industry representatives, country-level trade policies are one of the most important factors that affect U.S. firms' abilities to access foreign P&C insurance markets. The presence of NTMs can affect the ability of multinational insurance firms to enter foreign markets which, in turn, decreases competition and raises the price of insurance services. For example, provisions restricting the amount of foreign equity in domestic insurance firms may limit such firms' control over their overseas operations, a factor which may discourage foreign market entry. A summary and analysis of the nature and potential effect of NTMs on the P&C insurance industry are provided in chapter 4 of this report.

As one of the P&C insurance industry's primary operating expenses, the cost and availability of labor can also affect the supply of P&C insurance. Insurance firms prefer to fill most positions with college graduates, and often provide additional specialized training to their employees. This explains, in part, the relatively high wages earned by insurance industry employees. For example, U.S. insurance employees in nonsupervisory positions earned an average of \$798 per week, which is higher than the U.S. private industry average of \$568 per week.⁴⁶ Moreover, the U.S. insurance industry has been slow to adopt labor-saving technological innovations, lagging behind other segments of the financial services sector. This may be due to the complex nature of insurance products, security concerns, the difficulty and high cost of developing and maintaining online systems, or insurers' reluctance to encourage increased competition by facilitating online policy and price comparisons, among other factors.⁴⁷ Further, certain tasks cannot be accomplished electronically, such as face-to-face client-agent consultations (especially when they relate to complicated policies) and damage assessment.⁴⁸

According to industry representatives, government regulations requiring the approval of new types of insurance also can affect the supply of insurance services. Regulation of this type, referred to as policy form regulation, has the potential to affect the amount of time

⁴⁵ Standard & Poor's, *Insurance: Property-Casualty; Asia*, February 2007, 17; Standard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 17; and Standard & Poor's, *Insurance: Property-Casualty; Europe*, September 2007, 17.

⁴⁶ USDOL, BLS, "Career Guide to Industries: Insurance," March 12, 2008.

⁴⁷ Lewin, "Insurance Industry Lags Behind in Technology," June 5, 2006.

⁴⁸ USDOL, BLS, "Career Guide to Industries: Insurance," March 12, 2008.

required to introduce new insurance products. In the United States, the median time from registration with regulatory authorities to product release in states maintaining policy form regulations was 72 days, as compared to 43 days in states lacking such regulations.⁴⁹ In general, the insurance industry believes that policy form regulation raises compliance costs and increases the time to market for new insurance products, potentially impairing market innovation and first-mover advantages.⁵⁰

Demand Factors

Economic factors such as economic growth, cost of living, and unemployment levels affect the consumption of insurance products, with demand usually rising as prosperity increases. Industry representatives report that economic growth is one of the most important factors explaining differences in demand across countries.⁵¹ In some developing countries, economic development has led to the emergence of a middle class. These households tend to acquire valuable property such as homes and automobiles, all of which typically require insurance. In addition, empirical studies on the factors affecting demand for P&C insurance confirm that real GDP per capita is highly positively correlated to insurance consumption.⁵² Similarly, quantitative work conducted by Commission staff also demonstrates a clear, positive relationship between per capita income growth and P&C insurance premium growth across a large sample of countries (figure 2.4).⁵³ Relatedly, consumers tend to purchase more insurance in countries exhibiting a high cost of living, largely because property in such locations tends to be more highly valued. Not surprisingly, unemployment levels also tend to affect demand for insurance services, with lower levels of unemployment spurring increased insurance purchases. By contrast, demand for insurance tends to fall during periods of high unemployment, as some consumers are unwilling or unable to assume the cost of maintaining insurance policies.

Demand for P&C insurance also tends to be greater in areas characterized by high population density, due to higher property values as well as higher per capita levels of crime and other loss-incurring events than in more sparsely populated areas. Among the top 10 developed countries, for example, three of the five largest P&C insurance markets in 2006—Japan, Germany, and the United Kingdom—were also the most densely populated. Exceptions occur in countries like Australia, Canada, and the United States, where demand for insurance is high, but population density is relatively low due to the abundance of land.

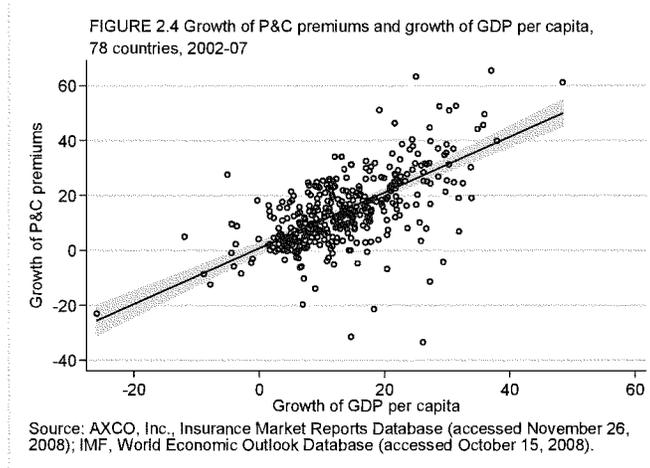
⁴⁹ Cummins, "Deregulating Property-Liability Insurance," 2002, 16.

⁵⁰ *Ibid.*, 18. Since regulators typically require higher levels of scrutiny for insurance sold to individuals, the arguments against policy form regulation are typically restricted to commercial lines.

⁵¹ Industry official, telephone interview by Commission staff, December 2, 2008.

⁵² Esho, et al., "Law and the Determinants of Property-Casualty Insurance," June 2001, 11. The correlation coefficient is 0.85.

⁵³ The scatter plot displayed in figure 2.4 contains data on income and premium growth for 78 countries from 2002 through 2007, for a total of 388 observations. A regression line through the scatter plot displays a positive relationship, with a regression coefficient significant at all levels of confidence. The shaded area around the regression line indicates the confidence interval. See appendix D for more details.



Government regulation can also affect demand for P&C insurance products. Indeed, government-required insurance coverage, referred to as compulsory lines, tends to increase demand for insurance products. For example, most countries require that consumers and businesses purchase some type of automobile insurance, a factor which likely boosts demand beyond the level that would exist in the absence of such regulations.

Finally, the actual and perceived threat of catastrophic events such as hurricanes, earthquakes, and even terrorist attacks also stimulates demand for P&C insurance services. Indeed, demand for terrorism insurance has reportedly increased since the September 11, 2001, terrorist attacks. In the period immediately following the attacks, demand for terrorism insurance spiked, just as insurance firms were scaling back their P&C insurance offerings and raising premium prices. In some cases, insurance firms stopped issuing terrorism-related insurance policies altogether.⁵⁴ Over time, however, demand for terrorism insurance decreased, even as insurers began to offer policies at more favorable prices. Although demand for terrorism insurance has declined since the 2001 terrorist attacks, and prices have consistently fallen, terrorism insurance represents a potentially important segment of the overall P&C insurance market. The perception that climate change may be driving increasingly frequent and damaging weather-related events, such as hurricanes, fires, floods, and droughts, is also reportedly leading to higher demand for both P&C insurance and reinsurance services (box 2.3). Due to high levels of uncertainty surrounding climate change threats, however, many P&C insurance companies are grappling with the difficulties associated with the development and pricing of such policies, largely because miscalculation raises the potential for catastrophic losses.⁵⁵

⁵⁴ O'Connor, "Recent Trends in the Catastrophic Risk Insurance/Reinsurance Market," 2005, 47.

⁵⁵ *Ibid.*, 44.

BOX 2.3 Reinsurance

Reinsurance, commonly referred to as insurance for insurance companies, is an insurance transaction in which one company (the assuming insurer, or reinsurer) indemnifies, for a premium, a primary insurance company (the ceding insurer) against all or part of the loss that it may sustain from its insurance policies. A reinsurer, in turn, may purchase reinsurance from another reinsurer, a transaction known as retrocession.^a One of the most important functions of reinsurance is to protect P&C insurers against unforeseen, catastrophic events that threaten to overwhelm loss reserves, including events like large-scale hurricanes and earthquakes. Insurance companies also use reinsurance to increase insurance capacity, limit liability exposures, and stabilize operating results.^b

An insurance company's reinsurance requirements are determined by company-specific factors, including its book of insurance business, its underwriting strategy, and its financial position. As a result, reinsurance contracts, and premiums, must be customized to take into account each insurer's unique circumstances. Reinsurance transactions are typically structured as either facultative contracts or treaty contracts. Facultative contracts provide coverage for a specific individual risk (like, for example, a high-risk building), usually because the primary insurance company considers the risk too large to absorb on its own. By contrast, treaty contracts cover a portion of an entire class or classes of business, like homeowners' insurance. An insurance company may purchase a single reinsurance contract or may purchase several treaties to achieve the desired level of coverage, a process known as *aslaying*. Under such arrangements, reinsurers pay claims, as necessary, in a predetermined sequence in response to loss events.^c

The leading suppliers of reinsurance services tend to be large multinational insurance companies that specialize in such services, mainly Swiss Re (Switzerland), Munich Re (Germany), Berkshire Hathaway (United States), and Hannover Re (Germany). Reinsurance can also be purchased from the reinsurance departments of primary insurers. In 2007, the global reinsurance market was valued at approximately \$168 billion,^d exhibiting a compound annual growth rate of approximately 6 percent from 2003 through 2007. Of this total, Munich Re accounted for approximately 18 percent of the global market, followed by Swiss Re (16 percent), Berkshire Hathaway (7 percent), and Hannover Re (3 percent). All other sources of reinsurance services accounted for approximately 57 percent of the global market.^e In 2007, the largest regional market was the Americas, which represented 56 percent of the global market, followed by Europe (35 percent), and the Asia-Pacific region (10 percent).^f Primary P&C insurance companies based in the United States ceded approximately \$58 billion to reinsurers in 2007, largely to firms based in Bermuda (52 percent), Switzerland (17 percent), and the United Kingdom (9 percent). Overall, foreign reinsurers represented approximately 83 percent of the U.S. reinsurance market in 2007.^g

In general, the reinsurance industry faces similar market conditions to that of primary insurers, particularly the ups and downs of the underwriting cycle, wherein premium pricing conditions exhibit "soft" market conditions (i.e., the cycle is characterized by excess capital and underwriting capacity) and "hard" market conditions following large-scale catastrophes that drain capital from the market. During 2008, for example, the global reinsurance industry, like the P&C insurance industry, faced highly competitive market conditions characterized by soft market conditions, excess underwriting capacity, and turbulent financial markets, a situation which may lead to underperformance and/or losses on reinsurers' investment portfolios. In response to such conditions, the reinsurance industry reportedly maintained underwriting discipline in 2008, largely to preserve capital in uncertain times.^h

^aRAA, "RAA Fundamentals of Property Casualty Reinsurance," 2008; Datamonitor, "Global Reinsurance," April 2008, 12; and Standard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 9.

^bRAA, "RAA Fundamentals of Property Casualty Reinsurance," 2008.

^c*Ibid.*

^dThe global reinsurance market is measured as the amount of gross written premiums ceded to reinsurers. Datamonitor, "Global Reinsurance," April 2008, 7.

^eDatamonitor, "Global Reinsurance," April 2008, 12; Standard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 8, 11.

^fDatamonitor, "Global Reinsurance," April 2008, 10.

^gInsurance Information Institute, "Facts and Statistics: International," undated (accessed January 21, 2009).

^hStandard & Poor's, *Insurance: Property-Casualty*, July 10, 2008, 9; Fitch Ratings, *2008–2009 Global Reinsurance Review & Outlook*, September 2008, 1, 3–4.

Factors Affecting Both Supply and Demand

The number of insurers in a country market can affect both the supply and demand for P&C insurance services. In general, the supply of insurance is greater in countries with a relatively high number of insurance companies, as companies compete with each other on not only the basis of price but also by offering new (or improved) insurance products.⁵⁶ Such competition, in turn, tends to increase demand for such services. For example, Liberty Mutual's experience in Colombia illustrates how the entrance of a foreign insurance company into a previously protected market can boost both the supply and demand of P&C insurance services. After entering the Colombian P&C market, Liberty Mutual addressed a previously underserved market by supplying taxicab insurance.⁵⁷ Such insurance proved to be extremely popular with taxicab drivers, resulting in increased demand and rapidly growing sales for Liberty Mutual. By the end of 2007, Liberty Mutual controlled approximately 40 percent of Colombia's market for taxicab insurance.⁵⁸

A country's institutional and business climate can affect the supply and demand for insurance services. For instance, a country's financial regime can affect supply. The insurance industry relies fairly heavily on investment income, and thus insurers tend to offer a greater supply of insurance in countries with sophisticated financial markets as they can invest their reserves in a wide variety of equity, fixed-income, and other investments.⁵⁹ Access to global capital markets can increase investment opportunities, however government regulations often restrict cross-border capital flows and dictate the types of investments in which insurance companies are permitted to invest loss and unearned premium reserves and policyholders' equity.

The development of a country's legal and property rights regimes also likely influences the decisions of insurance companies to supply insurance as well as the purchasing decisions of insurance customers. On the supply side, the development of a country's legal system, and the enforcement of contracts, has an important bearing on company-level decisions to enter foreign markets.⁶⁰ On the demand side, the existence and enforcement of property rights, which protect consumers from loss or damage to an asset, provides an economic incentive to acquire and insure property. Quantitative research indicates a strong relationship between property rights and P&C insurance consumption per capita.⁶¹

The enforcement of creditor rights also may increase demand for P&C insurance products. For example, consumers of both personal and commercial lines are more likely to purchase insurance if they believe that their policies will be honored under all circumstances, even in situations involving the insolvency of an insurance company.⁶² Indeed, several developed countries require insurance companies to participate in state-run insurance guaranty funds wherein financially stable companies assume responsibility

⁵⁶ Hartwig, Insurance Information Institute, Written submission to the USITC, October 2, 2008, 7.

⁵⁷ Taxicab insurance protects taxicab drivers from damage, to or theft of, their taxicabs. To facilitate the recovery of vehicles and ensure that taxicab drivers are able to continue to operate after a theft incident, Liberty Mutual installs Lo-Jack on all insured taxicabs and offers loaner cars.

⁵⁸ Industry official, interview by Commission staff, December 17, 2008.

⁵⁹ Esho, et al., "Law and the Determinants of Property-Casualty Insurance," June 2001, 11.

⁶⁰ Industry representative, telephone interview by Commission staff, December 2, 2008.

⁶¹ Esho, et al., "Law and the Determinants of Property-Casualty Insurance," June 2001, 16, 20.

⁶² *Ibid.*, 5.

for claims made by insolvent insurers' customers, thereby removing a significant financial risk to consumers.⁶³

Last, the regulation of P&C insurance premium prices by national governments has the potential to affect both the quantity of insurance supplied and demanded.⁶⁴ In general, premium price regulation is designed to avoid two situations: excessive price competition among insurers and price collusion among firms that could artificially inflate premiums.⁶⁵ The insurance industry, however, argues that price regulation often leads to rate suppression⁶⁶ and the cross-subsidization⁶⁷ of high-risk consumers,⁶⁸ factors which may encourage insurers to limit the quantity of insurance supplied in regulated markets, or opt out of such markets altogether. Government-mandated prices, which are typically lower than free market prices, also tend to increase the quantity of insurance products demanded,⁶⁹ a factor which may lead to a shortage of insurance services for regulated insurance products.

⁶³ AIA, "Insurance 201: Property-Casualty Finance," September 7, 2006, 2.

⁶⁴ Price regulation is typically restricted to personal lines and workers' compensation.

⁶⁵ Cummins, "Deregulating Property-Liability Insurance," 2002, 6.

⁶⁶ Rate suppression occurs when government-mandated premiums provide insufficient revenue to cover loss payouts.

⁶⁷ Cross-subsidization occurs when government pricing caps prevent insurers from charging higher rates to high-risk customers, potentially increasing insurers' overall risk and requiring price increases on lower-risk customers.

⁶⁸ Cummins, "Deregulating Property-Liability Insurance," 2002, 12.

⁶⁹ Hartwig, Insurance Information Institute, Written submission to the USITC, October 2, 2008, 7.

CHAPTER 3

International Trade in Property and Casualty Insurance

Nature of Trade: Cross-Border Trade vs. Affiliate Sales

Insurance companies compete in the global market in two distinct ways—through cross-border exports and imports, and through sales by affiliates located in host markets. Cross-border trade is more analogous to exports and imports of merchandise. In this case, an insurance company in one country sells an insurance policy to a customer in another country. When the insurer is located in the United States and the customer is located elsewhere, the sale is classified as a U.S. export. When the insurer is located outside of the United States and the customer is a U.S. resident, or a U.S.-based firm, the transaction is classified as a U.S. import of insurance services.

However, cross-border trade in insurance services is often restricted, largely because insurance regulators in many countries prohibit cross-border sales of personal lines, as it is often difficult to ensure the solvency of foreign insurance companies, and thus, their ability to pay claims. For this reason, most cross-border trade in insurance services involves so-called “sophisticated consumers,” primarily large corporations operating in global markets and insurance companies purchasing reinsurance contracts from specialized reinsurance firms.

BOX 3.1 The GATS and Trade in Insurance Services

The General Agreement on Trade in Services (GATS), one of the founding agreements of the WTO, defines trade in services through four “modes.” Those most relevant to trade in insurance services are mode 1 (cross-border supply), equivalent to cross-border trade, and mode 3 (commercial presence), equivalent to sales through affiliates. In mode 1 trade, services are provided across borders. By contrast, in mode 3 trade, service providers establish a commercial presence, through which they offer their services directly in the host market.

Insurers also compete internationally by establishing and operating subsidiary companies abroad, commonly referred to as foreign affiliates. A foreign affiliate is typically licensed locally and subject to the full supervision of local insurance regulators. As a result, once established in a new market, foreign affiliates typically face few restrictions on the sale of insurance. Many global insurers also try to leverage their international brand names by hiring local insurance agents, or working through other distribution channels in the host market, such as banks or postal centers. Other global insurers enter into joint venture arrangements with local insurers, bringing capital, managerial expertise, and product

knowledge to foreign markets. Even though the sale of insurance through foreign affiliates takes place entirely in a foreign country (both the seller and the buyer are located in a foreign market), it is considered a form of services trade, identified as “affiliate transactions” (box 3.1).

Trade in insurance services can provide benefits for market participants in both exporting and importing countries. An early, influential paper on trade in insurance services cited three expected benefits to importing countries, particularly developing-country markets, from engaging in cross-border insurance trade:

- Increased competition should bring greater diversity of insurance products and lower prices to consumers
- Increased domestic market capacity should reduce the concentration of risk in a single market, decreasing the likelihood of market disruptions
- Increased competition should reduce the ability of anticompetitive practices, such as cartels, to distort markets¹

More recently, other observers have cited additional benefits to developing countries of opening their financial services markets to foreign companies, including insurance firms. For instance, the entry of foreign firms can bring jobs to the local market and increase competition for domestic firms, forcing those firms to improve their existing operations.² By contrast, exporters of insurance services profit by expanding their sales in foreign markets, particularly in many fast-growing developing-country markets, and by diversifying their risk geographically. Insurance companies also benefit from their ability to sell insurance to multinational customers around the world.

As discussed in chapter 2, the P&C insurance industry is split into two market segments, commercial lines and personal lines. International trade in each segment is driven by different factors. International trade in commercial lines insurance is usually conducted via cross-border trade and is driven by the needs of large multinational firms, many of which have offices and facilities in multiple countries requiring some form of insurance. Moreover, the practice of insuring multinational companies with master insurance policies designed to cover a single company's entire global insurance needs under a single contract encourages cross-border commercial insurance transactions. Examples of master policies include property insurance for business facilities worldwide and/or directors' and officers' liability and errors and omissions insurance for executives in multiple locations. Although master policy arrangements are often preferred by both P&C insurance companies and their multinational clients, local country regulations sometimes limit such arrangements, requiring global insurers to establish affiliates in multiple countries.³ The distribution system for commercial insurance, which revolves around insurance brokers, also tends to promote international trade in insurance services. Insurance brokers, including firms like Marsh & McLennan and Aon, typically operate on a global basis, and frequently develop packages for their multinational clients.⁴

The practice of insuring very large risks using syndicated arrangements also promotes cross-border trade in commercial lines. Under such arrangements, which are often coordinated through insurance brokers, insurance coverage for very large risks is split among several insurance companies, some that may be located in different countries.

¹ Skipper, "Foreign Insurers in Emerging Markets," 1997, 2-3.

² Coalition of Service Industries, "Making the Most of the Doha Opportunity," 2006, 10-12.

³ USITC, Hearing transcript, September 23, 2008, 140-46 (testimony of Michael Moran on behalf of Council of Insurance Agents and Brokers; David Snyder on behalf of American Insurance Association; and Robert Gordon on behalf of Property Casualty Insurers Association of America); Moran, Written testimony to the USITC, September 23, 2008, 6-7.

⁴ For example, see CIAIB, "Opening Markets for Insurance Agents & Brokers," May 3, 1999, Written submission to the USITC, October 9, 2008, 1-2.

Examples of large risks include nuclear power plants, commercial satellites, and particularly well-known or high-value real estate.⁵ Last, some commercial insurance products, particularly marine, aviation, and transport (MAT) insurance, which provides insurance for international transport vehicles like ships and airplanes, as well as goods in transit, are often sold on a cross-border basis.

Unlike commercial lines, which tend to be traded across borders, personal lines insurance is typically sold through insurers' affiliate companies located in foreign markets because of individual preferences and regulatory requirements. Consumers, most of whom do not have expertise and familiarity with foreign insurance companies, markets, and regulations, often prefer to purchase insurance from locally recognized companies, usually through insurance agents and/or bancassurance methods. Such consumers are unlikely to buy insurance from companies based abroad, although such purchases have become somewhat more feasible given the rise of Internet distribution channels. Since individual consumers are considered to be less sophisticated than multinational firms, they generally receive the highest level of protection from national insurance regulators. As a result, personal lines are more likely to be sold through foreign affiliates due to regulatory requirements for a local commercial presence, subject to full regulatory supervision. Despite such scrutiny, insurance firms are actively seeking to sell personal lines through affiliate companies. For example, Liberty Mutual, a U.S.-based firm that offers both personal and commercial insurance, has established an affiliate in China that concentrates on personal lines insurance, particularly automobile insurance. Liberty Mutual's affiliate in China is one of 14 such affiliates around the world that focuses on personal lines insurance in foreign markets. The company has also announced plans to open an affiliate in India, with tentative plans to offer both personal and commercial insurance.⁶

Factors Driving International Competition in P&C Insurance

An important motivation for international trade in insurance services is simply insurers' desire to access growing markets. In general, the P&C insurance markets of most developed countries have moved into the mature stage of the industry life cycle, characterized by high levels of insurance penetration⁷ and slow growth rates, providing strong incentives for companies based in those markets to expand abroad, particularly to the high-growth markets of many developing countries. In our sample of developed countries, for example, insurance penetration averaged 9 percent in 2007, compared with an average of 3 percent in our sample of developing countries.⁸ As noted in chapter 2, demand for insurance services tends to grow with a country's overall level of development, largely because increasing numbers of individuals and businesses both feel the need for and can afford insurance coverage. In addition, as automobile ownership increases along with economic development, national regulators typically require some form of mandatory automobile insurance, an important factor driving demand for P&C insurance in many developing countries. A growing awareness of risk mitigation techniques in many developing countries, particularly among business customers, also

⁵ Examples include the World Trade Center in New York before the attacks of September 11, 2001, or international landmarks such as the Eiffel Tower in Paris.

⁶ Liberty Mutual, "International Operations," undated (accessed November 14, 2008); industry official, interview by Commission staff, Chongqing, China, September 6, 2007.

⁷ Insurance penetration is calculated as insurance premiums as a percentage of national GDP.

⁸ Country groups as defined by Swiss Re Corporation. Data from Swiss Re, "World Insurance in 2007," table 1, 2008, 33.

tends to drive demand for insurance services. Taken together, these factors suggest that developing-country insurance markets are likely to grow rapidly for many years to come. Many U.S. firms are interested in entering and/or operating in the P&C insurance markets of developing countries. In addition to AIG, which sells insurance in dozens of developing countries, Liberty Mutual also has established operations in many developing countries. Liberty Mutual typically enters such markets by purchasing a local insurance company, and then expands market share by identifying underserved product segments.⁹

Factors Driving Firms to Compete Internationally

The size of an insurance company's national market also may provide an incentive to engage in international trade. For example, many of the world's leading P&C insurance companies are based in Europe, often in countries characterized by relatively small insurance markets; this may be a factor that encourages EU firms to search for revenue growth outside their respective home-country markets. By contrast, most U.S. insurance companies have not historically operated outside the United States, largely because business opportunities in the large, diverse U.S. insurance market have likely reduced the incentive for U.S. firms to venture abroad. Indeed, of the 2,343 licensed insurance companies in the United States, fewer than 25 can be identified as being actively involved in foreign markets. In addition, the U.S. state-based system of insurance regulation likely encourages this focus on the domestic market, largely because many U.S. P&C insurers only operate within a single U.S. state. Domestic insurers that did move into foreign markets likely responded to a particular set of circumstances, i.e., a corporate culture predisposed to international ventures and/or the particular interests of a company's management team.¹⁰ For example, the U.S. insurance firm with the broadest international operations, AIG, evolved from a company founded in Shanghai, China, in 1919. Since that time, AIG's corporate leadership has remained active in international markets, expanding into dozens of countries over the past 90 years.¹¹

Cross-Border Trade as a Share of the Global Insurance Market

Although the insurance industry calculates revenues and market size in terms of gross premiums written, government statistics for most countries tend to follow guidelines established in the IMF's *Balance of Payments Manual*. As a result, many governments and international organizations report cross-border trade in insurance services as premiums collected from nonresidents, net of claims paid to nonresidents.¹² Although comprehensive statistics pertaining to total global cross-border trade in insurance services

⁹ Industry official, interview by Commission staff, December 17, 2008.

¹⁰ Harold Skipper and Robert Klein (professors, Georgia State University), interview by Commission staff, Atlanta, GA, November 10, 2008; industry representative, interview by Commission staff, New York, NY, November 19, 2008.

¹¹ AIG, "History," undated (accessed November 14, 2008).

¹² In principle, the ratio of premiums to claims should reflect payments within a single year. However, to account for variations in claims payments due to unforeseen events in a particular year, the IMF advises country statistical agencies to base the ratio on a "medium- to long-term period." IMF, *Balance of Payments Manual*, 1993, 66–67. The Bureau of Economic Analysis follows this system for reporting U.S. cross-border insurance trade statistics, reporting "normal" claims payments derived from actual claims averaged over several years. USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," table 6.1, October 2008, 52.

do not exist, premiums collected through cross-border sales likely account for a very small share of overall global insurance premiums. As an illustration, the Commission developed a ratio measuring cross-border exports of P&C insurance as a share of net premiums. The ratio was developed using P&C insurance export data for 14 available OECD countries, and then dividing such export data by net premium data for each country (table 3.1).¹³ Overall, the average for the reporting OECD countries indicates that cross-border exports of P&C insurance likely represent less than 3 percent of global net premiums.

For most countries, the ratio of exports to net premiums is significantly smaller than the overall OECD average, which is skewed by significantly larger ratios for several countries, particularly Ireland and Luxembourg, both of which are countries with small domestic insurance markets and many offshore foreign insurance companies.

TABLE 3.1 Cross-border exports as a share of total P&C insurance, 2006

OECD Country	Exports	Gross premiums	Gross claims	Net premiums (premiums-claims)	Exports/net premiums
Millions of \$					%
Australia	24	21,723	13,819	7,904	(^a)
Czech Republic	9	3,316	1,678	1,638	1
Germany	307	184,678	96,763	87,915	(^a)
Hungary	5	1,928	1,003	925	1
Ireland	5,838	9,104	4,310	4,794	122
Italy	597	51,030	31,142	19,888	3
Korea	164	35,349	13,418	21,931	1
Luxembourg	364	1,272	705	567	64
Norway	320	7,701	4,679	3,022	11
Poland	26	5,292	2,697	2,595	1
Slovak Republic	6	953	399	554	1
Sweden	433	13,728	8,149	5,579	8
United Kingdom	378	127,676	43,958	83,718	1
United States	3,046	469,035	261,055	207,980	2
OECD average					3

Sources: OECD, OECD Stat Extracts, Trade in Services by Partner Country Database; AXCO, Inc., Insurance Market Reports Database (accessed October 2, 2008).

Notes: Data for the United States and the United Kingdom are for 2005. Data for all countries are from OECD, except for U.S. data from AXCO, which excludes personal accident and health care insurance. OECD data include "other direct" and freight insurance, but do not include reinsurance. Although the OECD reports such data exclusive of reinsurance services, Ireland's exports likely include reinsurance services.

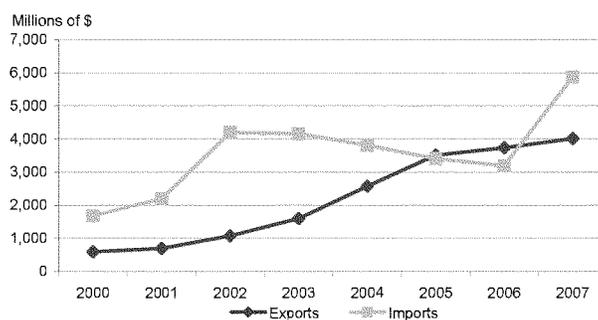
^aLess than 0.5 percent.

¹³ According to Swiss Re, OECD countries account for 90 percent of global insurance premiums. Swiss Re, "World Insurance in 2007," 2008, 35 and 39. Moreover, due to a variety of factors, OECD countries most likely account for an even larger share of global cross-border P&C insurance exports, largely because developed economies are more likely to engage in cross-border trade than emerging markets. Such factors include highly sophisticated primary insurance companies that purchase reinsurance services from global reinsurance firms, as well as a larger number of multinational corporations that are likely to buy insurance on a cross-border basis.

U.S. Cross-Border Insurance Trade¹⁴

U.S. cross-border exports of primary insurance services reached \$4.0 billion in 2007, compared with U.S. imports of \$5.9 billion (figure 3.1).¹⁵ From 2000 through 2007, both imports and exports recorded strong growth, with compound annual growth rates of 11 percent and 21 percent, respectively. Although U.S. government statistics combine cross-border trade data for life insurance and P&C insurance, many industry observers believe that P&C insurance accounts for the vast majority of such trade.¹⁶

FIGURE 3.1 Total U.S. cross-border exports and imports of primary insurance services, 2000–2007



Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade 1986–2007," table 5: Insurance, undated (accessed July 21, 2008, and January 7, 2009).

Historically, U.S. imports of insurance services have exceeded U.S. exports, largely because the majority of cross-border imports consist of reinsurance rather than primary (direct) insurance, and most of the world's largest reinsurance firms are located outside the United States. In recent years, however, U.S. cross-border exports of insurance services have increased relative to imports, with exports equaling or exceeding imports in 2005 and 2006. In 2007, imports increased sharply, partly as a result of rising premiums in the U.S. market resulting from the difficult 2005 hurricane season.¹⁷

The top seven markets for U.S. cross-border insurance exports account for 77 percent of the total (figure 3.2). In 2007, the largest market for U.S. insurance exports was Canada, which accounted for 38 percent of the total, followed by Switzerland (12 percent) and Ireland (9 percent).

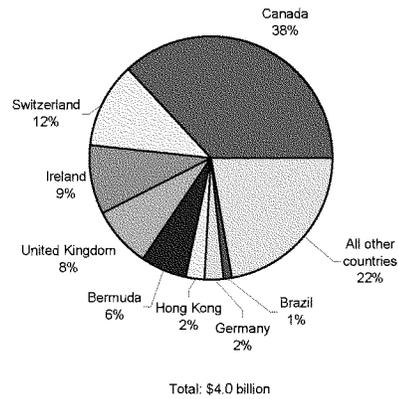
¹⁴ BEA data for cross-border trade in insurance do not separate life from P&C insurance. These data also include trade in agents, brokers, and auxiliary insurance services, which are believed to be relatively small.

¹⁵ For additional discussion of international trade trends in insurance, see USITC, *Recent Trends in U.S. Services Trade*, 2008.

¹⁶ Industry officials, interview by Commission staff, November 10, 2008.

¹⁷ USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," October 2008, 27.

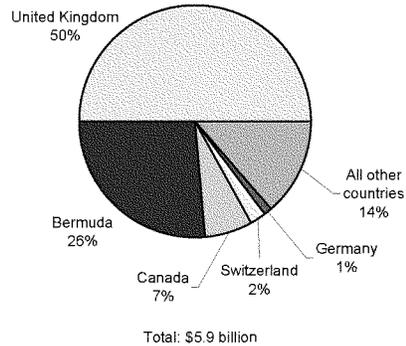
FIGURE 3.2 U.S. insurance exports by major country, 2007



Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," table 6.2, October 2008.

U.S. insurance imports are even more highly concentrated than exports (figure 3.3). Fully one-half of U.S. imports originate in the United Kingdom, reflecting the prominence of that market in specialty insurance lines, particularly MAT insurance and insurance for large risks. Bermuda accounts for another 26 percent of U.S. imports, reflecting not only MAT insurance written in that country, but also the presence of many U.S. captive insurers located in Bermuda for tax purposes (box 3.2). Switzerland also accounts for a significant share of U.S. imports of insurance services. As a prominent international insurance center, Switzerland is home to several of the world's largest insurance companies, including Swiss Re, Winterthur, and Zurich Financial Services. Due to the small size of the Swiss domestic insurance market, Swiss insurers write more than 75 percent of their direct P&C premiums abroad.¹⁸

¹⁸ IMF, *Switzerland Factual Update*, June 2007.

FIGURE 3.3 U.S. insurance imports by major country, 2007

Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," table 6.2, October 2008.

BOX 3.2 Captive Insurers

A captive insurer is a company that is created and funded by one or more noninsurance companies for the purpose of providing insurance coverage to its owner(s). As an alternative to traditional insurance, captives first emerged in the 1980s during a period in which many businesses experienced difficulty obtaining certain types of commercial insurance coverage. From 1989 through 2007, the worldwide number of captives more than doubled to 5,119 firms. The number of captives based in the United States grew dramatically in 2006, with Arizona, Nevada, and Utah posting growth that approached or topped 50 percent. With 1,251 licensed captives, the United States was the largest captive domicile in 2006, followed by Bermuda with 989 firms. Although several U.S. states have legislation that permits the establishment of captive insurance firms, Vermont has become a particularly prominent host to captives, with 563 captive insurance entities established in the state by the end of 2006. Overall, Vermont ranked third among captive locations worldwide in 2006, following Bermuda and the Cayman Islands.

Sources: Insurance Information Institute, "Glossary of Insurance Terms," undated (accessed February 12, 2008); Insurance Information Institute, "Captives and Other Risk-Financing Options," August 2008; Moody, "Vermont: The Gold Standard," August 5, 2005; Geisel, "25 Years After Law," August 7, 2006; and Lenckus, "Onshore Domiciles Continue to See Growth in Captives," March 3, 2008.

The fastest-growing insurance markets for U.S. cross-border trade are identified in table 3.2. U.S. exports of primary insurance services increased at a compound annual growth rate (CAGR) of 31 percent from 2000 through 2007, with imports increasing at a rate of 20 percent. Among developed countries, U.S. exports increased fastest to Switzerland, Bermuda, and Belgium-Luxembourg.¹⁹ Exports to Europe increased at a CAGR of 42 percent. Among developing countries, export growth rates were fastest to

TABLE 3.2 Fastest-growing markets for cross-border insurance trade, 2000 and 2007

	U.S. Exports			U.S. Imports			
	2000 Millions of \$	2007	CAGR %	2000 Millions of \$	2007	CAGR ^a %	
All countries	592	4,012	31	1,685	5,878	20	
Selected developed countries				Selected developed countries			
Switzerland	1	462	158	Netherlands	1	14	46
Bermuda	4	249	83	Australia	3	26	37
Belgium-Luxembourg	1	16	60	Switzerland	22	137	30
New Zealand	1	12	53	Japan	4	22	28
Canada	78	1,477	52	Italy	1	5	26
Germany	5	99	51	Canada	82	391	25
Spain	1	10	49	Bermuda	340	1,555	24
Israel	1	13	40	Belgium-Luxembourg	5	21	23
Italy	1	9	33	France	12	49	23
France	4	26	32	United Kingdom	1,140	2,931	14
Selected developing countries				Selected developing countries			
Philippines	1	12	53	Brazil	(^b)	19	309
Malaysia	1	9	47	Indonesia	(^b)	18	305
Brazil	5	47	38	Venezuela	(^b)	8	261
China	4	23	30	Argentina	(^b)	5	238
India	1	2	19	Chile	(^b)	4	227
Venezuela	4	12	16	Mexico	2	11	27
Chile	6	10	7				
Mexico	31	37	3				

Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade 1986-2007," table 5: Insurance, undated (accessed July 21, 2008).

Note: BEA data used here include exports of primary insurance services only, for both life and P&C insurance. BEA included separate data

^aCompound annual growth rate. This calculation is based on unrounded, cross-border trade data supplied by the BEA.

^bLess than \$500,000.

¹⁹ Even though Ireland is a significant destination for U.S. exports and source of U.S. imports of insurance services, BEA began to report separate data for Ireland only in 2007, so it is not possible to calculate the growth rate of trade with Ireland. It is likely that growth has been significant in recent years, inducing BEA to present the data breakout for Ireland.

the Philippines, Malaysia, and Brazil. For all countries except Canada, U.S. exports grew from a very small base. Due to Canada's close economic relationship with the United States, many U.S. insurance companies that operate primarily in the U.S. market also operate in Canada. The increase in U.S. exports of insurance services to a growing number of countries reflects the large number of cross-border mergers and acquisitions in the insurance industry over the past decade,²⁰ the global spread of multinational companies, and, increasingly, the distribution of insurance over the Internet. U.S. imports of primary insurance grew fastest from the Netherlands, Australia, and Switzerland, among developed countries. Imports from Europe increased at a CAGR of 15 percent from 2000 through 2007.²¹ In terms of developing countries, U.S. imports increased fastest from Brazil and Indonesia, albeit from a very small base.²²

Global Cross-Border Insurance Trade

OECD data pertaining to cross-border trade in P&C insurance services cover most OECD member countries as well as several important nonmember countries.²³ Table 3.3 presents available data, for selected markets, for cross-border exports and imports of P&C insurance services from 2000 through 2006.²⁴ Such data are presented for the purpose of comparing trends in cross-border trade among countries.²⁵

In 2006, the largest single exporter of P&C insurance was Ireland, which reported total exports of \$5.8 billion. Ireland has become an important center of cross-border insurance trade in recent years, largely due to the creation of its International Financial Services Center in 1987, and to tax law changes in 2003 (box 3.3). The United States ranked second, with \$3.0 billion in exports of insurance services.²⁶ For all reporting countries, direct P&C insurance (including freight and other direct insurance) accounted for

²⁰ During the 2003–08 period, the Zephyr M&A database recorded an average of 94 cross-border M&A deals per year involving a U.S. company as the target or the acquirer. During the 1997–2002 period, the average was 25 cross-border M&A deals per year.

²¹ For additional discussion of international trade trends in insurance, see USITC, *Recent Trends in U.S. Services Trade*, 2008.

²² BEA reported zero imports from most developing countries in 2000, which makes it impossible to calculate a CAGR for those countries. To compensate, the Commission calculated the growth rates for Argentina, Brazil, Chile, Indonesia, Israel, and Venezuela using a 2000 U.S. import figure of \$1,000 (\$0.001 million).

²³ Not all OECD member countries report cross-border insurance trade data. Data for non-OECD member countries are available for Brazil, China, India, Indonesia, the Russian Federation, and South Africa. OECD, "Source OECD Services Statistics," undated (accessed October 8, 2008).

²⁴ The most recent year for which OECD data are available is 2006. The OECD does not report a single figure for P&C insurance. Instead, it reports separate data for life, freight, and "other direct" insurance, as well as reinsurance and auxiliary insurance services. For the purpose of this report, which focuses on primary insurance, P&C insurance is defined as the sum of the OECD data for freight insurance and other direct insurance. That number is presented where available, but not all countries report data for both the freight and other direct insurance categories. It is likely, but unconfirmed, that countries that do not report a separate figure for freight insurance include that category within other direct insurance, or simply do not report trade in freight insurance.

²⁵ The OECD does not report data for Bermuda, France, Switzerland, and the United Kingdom.

²⁶ However, U.S. data reported as "other direct" insurance by the OECD actually reflect both life and P&C insurance, so the United States may actually rank lower among reported countries. The United States does not break out life and P&C insurance exports. USDOC, BEA official, telephone interview by Commission staff, July 22, 2008.

TABLE 3.3 Global cross-border trade in P&C insurance services, selected markets, 2000–2006

Country	2000	2001	2002	2003	2004	2005	2006	CAGR ^a
	Millions of \$							%
Australia								
Exports	19	17	17	21	24	24	24	4
Imports	144	129	136	163	188	199	199	6
Brazil								
Exports	4	7	8	17	9	19	300	108
Imports	248	355	498	474	590	628	672	18
Germany								
Exports	192	169	239	262	325	327	307	8
Imports	341	341	414	562	792	806	928	18
Greece								
Exports	(^b)	(^b)	112	130	146	177	198	15
Imports	(^b)	(^b)	243	321	397	548	713	31
India								
Exports	247	253	290	354	748	585	828	22
Imports	(^b)	589	604	756	1,372	1,642	523	-2
Ireland ^d								
Exports	823	(^b)	2,587	5,798	6,078	4,579	5,838	39
Imports	1,016	(^b)	2,001	2,266	2,218	2,512	2,624	17
Italy								
Exports	375	518	624	488	601	535	597	8
Imports	319	404	473	393	488	578	798	16
Luxembourg								
Exports	(^b)	(^b)	112	173	240	351	364	34
Imports	(^b)	(^b)	72	59	59	51	79	2
Norway								
Exports	151	126	280	372	325	340	320	13
Imports	342	358	489	520	561	413	(^b)	4
Russian Federation								
Exports	(^b)	27	58	85	112	186	240	44
Imports	(^b)	22	38	66	24	60	59	18
South Africa								
Exports	451	(^b)						
Imports	360	204	225	297	391	479	587	8
Sweden								
Exports	238	222	234	367	361	405	433	11
Imports	53	83	99	49	47	53	33	-8
United States ^d								
Exports	502	574	877	1,153	1,759	2,743	3,046	31
Imports	1,685	2,016	3,771	3,634	3,162	2,978	2,739	8
Average growth rate								
Exports for all reporting countries								11
Imports for all reporting countries								28

Source: OECD, OECD Stat Extracts, Trade in Services by Partner Country Database.

Notes: Countries are selected based on available data reported by OECD. Data reflect the sum of OECD data for "other direct" and "freight" insurance for each country, which together reflect total P&C insurance. U.S. data include both life and P&C, but the overwhelming majority of trade data are believed to reflect P&C insurance.

^aCompound annual growth rate. The CAGR reflects available annual data starting with 2000; the calculation is based on unrounded data supplied by the OECD.

^bNot available.

^cSee box 3.3 for additional information on the growth of Ireland's trade in insurance services.

^dU.S. cross-border trade data included in this table differs from that contained in Figure 3.1 because the BEA data reported to the OECD does not include auxiliary insurance services.

BOX 3.3 The Growth of Ireland's Insurance Industry

Ireland created its International Financial Services Center (IFSC) in 1987. The IFSC is a special tax district in Dublin, created specifically to encourage the establishment of foreign financial services in Ireland. For foreign investors, important benefits of the IFSC include a 12.5 percent corporate tax rate, minimal reinsurance regulation, Ireland's network of 41 double taxation agreements, and the lack of restrictions on profit repatriation to treaty-partner countries. Benefits pertaining to profit repatriation include no withholding taxes on dividends or capital gains paid out to the parent company. These regulations make profit repatriation from Ireland significantly easier than from many other countries, an important consideration for global insurers and other financial firms.

Insurers operating in Ireland also benefit from attributes that have attracted many other foreign investors to the country. Ireland is in the same time zone as London's global insurance market, and investors benefit from access to the entire EU market through the EU Single Market Directive. Ireland also boasts a young, English-speaking, well-educated workforce with a large number of experienced insurance industry workers. In 2003, the 12.5 percent tax rate was extended to all of Ireland, attracting additional foreign financial firms.

Ireland's efforts to attract global financial firms have been quite successful. In the insurance sector, most such firms are captive insurers and reinsurance companies. More than one-half of the world's top 20 insurance companies maintain operations in Dublin, carrying out international activities including underwriting of direct insurance and reinsurance, as well as back office operations. Captive management is also an important activity, with approximately 220 captive insurers registered in the IFSC at the end of 2006.

These changes have encouraged many U.S. companies to locate their captive insurers in Ireland. In 2008, large U.S. firms with captives operating in Ireland included Hertz Corp., McDonald's, Delphi, Motorola, IBM, and Heinz Co.

Sources: International Financial Services Centre Online (accessed November 26, 2008); Willis Management (Dublin), Ltd., "Captive Insurance Company Management in Dublin, Ireland," undated (accessed November 26, 2008); KPMG, "International Financial Services in Ireland," 2007; and Bureau van Dijk, Orbis Companies Database (accessed December 1, 2008).

49 percent of total insurance exports in 2006, with reinsurance, primarily P&C reinsurance, accounting for 35 percent. The remaining 16 percent was life insurance. However, such averages mask significant variations among countries, with several small markets, including Brazil and Norway, exporting primary insurance almost exclusively. By contrast, Germany, which is home to several large, active reinsurance companies, reported that 90 percent of insurance exports constituted reinsurance. The United States and the United Kingdom also exported larger shares of reinsurance in 2006.

Total reported cross-border imports of insurance services were \$18.4 billion in 2006, with the United States and Ireland reporting \$2.7 billion and \$2.6 billion, respectively. Ireland's insurance imports consisted entirely of other direct insurance. As noted, cross-border trade statistics for the United States include both life insurance and P&C insurance services, and do not separately break out freight insurance.

Affiliate Transactions

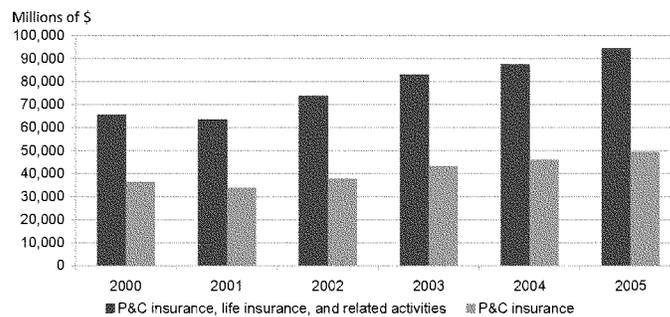
Although the U.S. government and the OECD both produce limited data on foreign firms' involvement in the domestic insurance markets of countries around the world, the two sources of data are not directly comparable. The following section uses U.S. government data to survey the role of U.S.-owned firms in foreign insurance markets, and the role of foreign-owned insurance companies in the U.S. market. The subsequent

section presents OECD data comparing foreign-owned insurance firms' involvement in the domestic insurance markets of reporting OECD countries.

U.S. Insurance Trade Through Affiliate Sales²⁷

Foreign affiliates of U.S.-based insurance companies recorded P&C insurance sales of \$94.4 billion in 2005, with such sales growing at a compound annual rate of almost 8 percent from 2000 through 2005 (figure 3.4).²⁸ By contrast, sales in the United States by the affiliates of foreign P&C insurance companies grew at the slightly slower rate of 6 percent during the same period, totaling \$49.4 billion.

FIGURE 3.4 Insurance sales by the foreign affiliates of U.S.-based firms, 2000–2005



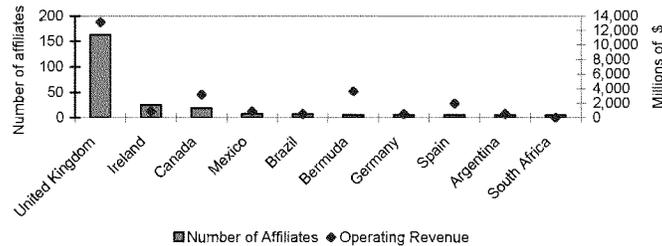
Source: USDOD, BEA, "Sales of Services to Foreign Persons by U.S. MNCs Through Their Nonbank MOFAs," table 10, undated (accessed July 21, 2008).

As of November 2008, U.S. parent companies owned equity shares in at least 294 active P&C affiliates around the world (figure 3.5), with the number of affiliates owned by each

²⁷ Includes sales of P&C insurance; excludes sales of life insurance and sales by agents, brokers, and auxiliary insurance service providers. BEA data for affiliate sales do not separate sales of primary insurance from reinsurance. Although it is likely that affiliate sales predominately reflect primary insurance, there are active foreign-owned reinsurance P&C affiliates operating in the United States, and U.S.-owned reinsurance P&C affiliates operating in foreign countries. In addition, some insurance carriers sell both primary insurance and reinsurance, making it difficult to separate sales of primary insurance from reinsurance by company.

²⁸ BEA released updated 2005 and 2006 data in October 2008, but changed its methodology, so the updated data are not comparable to data for 2005 and previous years. The older affiliate trade data presented sales by affiliates, equivalent to premiums. The new data present premiums net of claims, leading to a substantial decrease in the estimates of overall sales of insurance services by affiliates, and making the affiliate sales data comparable to the cross-border services data for the first time. In the new estimates, total sales of P&C insurance by U.S.-owned, foreign affiliates were \$19.5 billion in 2006, compared with \$17.1 billion in 2005. USDOD, BEA, "U.S. International Services: Cross-Border Trade in 2007," October 2008, 35.

FIGURE 3.5 Foreign affiliates of U.S. P&C insurers



Source: Bureau van Dijk, Orbis Companies Database (accessed October 2, 2008).

parent and their geographic distribution varying widely.²⁹ Of the total, 163 such affiliates were located in the United Kingdom, a clear illustration of the United Kingdom's leading role in the global P&C insurance market. These companies collectively reported \$13.2 billion in operating revenue, or 38 percent of the total operating revenue reported by all affiliates. Ireland and Canada ranked second and third, with 25 and 19 affiliates, respectively.³⁰

U.S.-based AIG has, by far, the most extensive international operations of all U.S. P&C insurance firms operating in foreign markets. Of the 294 U.S. affiliates currently active in the P&C business, 47 are owned by AIG. Overall, AIG maintains operations in 130 countries, although it is not clear how many of these affiliates/offices are engaged in the P&C insurance business.³¹ By contrast, Travelers Insurance has 14 affiliates, all of which are in the United Kingdom or Canada, and Liberty Mutual reports 11 affiliates.

Europe accounted for the largest share—approximately one-third—of P&C insurance sales by foreign affiliates of U.S.-based firms in 2005 (table 3.4). In Latin America and the other Western Hemisphere countries, U.S. firms recorded significant sales in Bermuda, Mexico, and Brazil. U.S. affiliates of foreign insurance firms recorded sales of P&C insurance services of \$46.9 billion in 2005.³²

²⁹ As reported by Bureau van Dijk, Orbis Companies Database (accessed November 25, 2008). P&C affiliates are those that are identified by the primary NAICS code 52412, defined as "direct insurance (except life, health, and medical) carriers," and that are owned by a U.S. parent with an equity share of at least 25.01 percent. By comparison, the database identifies 90 such companies that are majority owned (50.01 percent equity share) by U.S. parents.

³⁰ Not all affiliates report operating revenue, so the actual total is likely to be higher. None of the five U.S.-owned affiliates in South Africa reported operating revenue.

³¹ AIG Web site: <http://www.aig.com> (accessed January 14, 2009).

³² As previously noted, BEA has changed its methodology for calculating affiliate sales. As a result, updated data for 2006 are not comparable with the 2000–2005 data presented here. Using the new methodology, sales of P&C insurance by U.S. affiliates of foreign firms were \$20.0 billion in 2006 and \$17.4 billion in 2005.

TABLE 3.4 Share of global sales of P&C insurance by U.S.-owned foreign affiliates, by country, 2000–2005 (%)

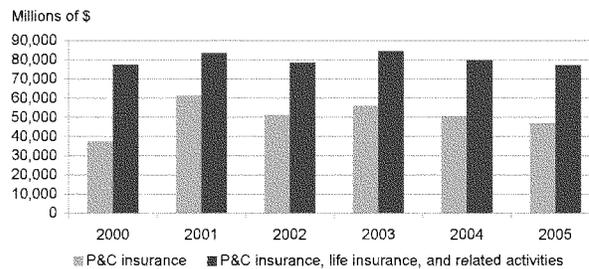
Country	2000	2001	2002	2003	2004	2005
Canada	8	9	10	11	12	10
Europe	41	40	41	40	37	34
France	1	1	1	2	2	(^a)
Germany	16	12	11	(^a)	7	7
United Kingdom	20	23	25	23	21	19
Other Western Hemisphere countries	28	27	25	24	27	28
Other Eastern Hemisphere countries	23	24	24	25	25	27
Australia	1	1	2	2	3	(^a)

Source: USDOC, BEA, "Sales of Services to Foreign Persons by U.S. MNCs Through Their Nonbank MOFAs," table 10, undated (accessed July 21, 2008).

Note: Affiliate sales data exclude life insurance, but include sales of reinsurance.

^aNot available.

Figure 3.6 illustrates sales of both life and P&C insurance by U.S. affiliates from 2000 through 2005. P&C insurance sales vary as a share of the total because such sales change in response to market conditions following major catastrophes, such as severe hurricanes or terrorist attacks. By contrast, sales of life insurance are relatively stable.

FIGURE 3.6 Sales by U.S. affiliates of foreign firms, 2000–2005

Source: USDOC, BEA, "Sales of Services to U.S. Persons by Foreign MNCs Through Their Nonbank MOUSAs," table 11, undated (accessed July 21, 2008).

Data pertaining to the sales of foreign companies' U.S. affiliates are limited, largely because most data are suppressed to avoid disclosing company-specific financial data. On a regional basis, however, such data reveal that the majority of P&C affiliate sales in the United States originate from affiliates whose parents are based in Europe. Since 2000, however, the European share of U.S. sales has slipped in favor of sales by companies based in Latin American and other Western Hemisphere countries, primarily Bermuda (table 3.5). The Bermuda insurance market began to grow rapidly following the September 11, 2001, terrorist attacks, due largely to surging demand for reinsurance services and captive insurance activity. The Bermuda insurance market has also benefited from several tax advantages (box 3.4).

TABLE 3.5 Regional shares of sales of P&C insurance services by U.S. affiliates of foreign companies, 2000–2005 (%)

Region	2000	2001	2002	2003	2004	2005
Europe	85	89	78	74	61	61
Other Western Hemisphere countries	6	5	(^a)	13	25	24

Source: USDOC, BEA, "Sales of Services to U.S. Persons by Foreign MNCs Through Their Nonbank MOUSAs," table 11, undated (accessed July 21, 2008).

Note: Affiliate sales data exclude life insurance, but include sales of reinsurance.

^aNot available.

BOX 3.4 Bermuda's International Insurance Industry

Bermuda is the world's fourth-largest domicile for reinsurance and a leading domicile for captives, with 1,305 international reinsurers and 840 captive insurers. In 2006, Bermudian insurers wrote premiums valued at \$115.8 billion. The largest lines were excess property, excess casualty, and property catastrophe reinsurance. Although known as a center of reinsurance, Bermuda's insurance market was actually comprised of 55 percent primary insurance and 45 percent reinsurance, measured by total premiums, at the end of 2006, with 66 percent of its exposure in North America. There are 22 Bermuda-based companies that are publicly traded, and many of the world's largest reinsurers and direct insurers also have Bermuda affiliates.

Two of Bermuda's largest insurers, ACE and XL Capital, were founded in the mid-1980s, in response to a shortage of liability insurance capacity in the United States. Capital shortages following three major U.S. catastrophes (Hurricane Andrew in 1992, the September 11th terrorist attacks, and the hurricane season of 2005, which included Hurricanes Katrina, Rita, and Wilma) each led to the formation of several new Bermudian insurers.

Several factors have led to Bermuda's growth as a center of international insurance activity: a favorable regulatory regime; a highly favorable tax environment; a convenient location for doing business in the United States; a local currency pegged to the U.S. dollar; and the existence of distinct operating advantages, including skilled personnel, and advanced communications systems. Bermuda also benefits from its reputation as a secure and diverse marketplace.

Specific tax advantages include Bermuda's lack of income, withholding, capital gains, premium, or profit taxes for corporations licensed in Bermuda, although insurers do pay a payroll tax and certain fees. However, U.S.-owned captives and other U.S.-owned insurers are taxed in the United States on their worldwide earnings. Some Bermudian-based insurers choose to be taxed in the United States as U.S. corporations, which allow them to avoid a U.S. federal excise tax on premiums paid to foreign insurers by U.S. customers. According to one estimate, effective tax rates on Bermudian insurers averaged approximately 15 percentage points lower than those on U.S. insurers in 2003–07. This difference has generated calls in the United States to change its tax policy as a way to level the playing field for U.S. firms, but so far the U.S. government has not taken action.

Regulatory advantages are also important to Bermudian insurers. Bermuda permits investors to establish new companies very quickly, which facilitates the quick injection of new capital into the global market in times of crisis, a role Bermuda has played vis-à-vis the United States following major catastrophe years since 1992. The Bermuda market has also encouraged alternative forms of risk management that substitute for traditional reinsurance, including the use of hedge funds to inject capital into the reinsurance sector, and the use of new products such as catastrophe bonds and catastrophe swaps.

According to one estimate, Bermudian insurers provide 40 percent of U.S. hurricane and earthquake reinsurance, account for 26 percent of the total U.S. reinsurance market, and directly support 9,600 jobs in the United States. The study, commissioned by the Association of Bermuda Insurers and Reinsurers, also asserts that Bermudian insurers indirectly support an additional 14,000 U.S. jobs.

Sources: AXCO, Inc., "Bermuda: International Market," undated (accessed November 14, 2008); Fitch, "Bermuda Market Overview," March 3, 2008; and GSP Consulting Corp., "Analysis of the U.S. Economic Impact," November 2007.

Note: Excess property and excess casualty insurance lines represent coverage not available from an insurer licensed within a local market (an admitted carrier), so that coverage must be purchased from an insurer outside of the local jurisdiction (a nonadmitted carrier). Insurance Information Institute, "Glossary of Insurance Terms," undated (accessed February 12, 2008).

Global Insurance Trade Through Affiliate Sales

For 2006, OECD data cover foreign companies' share of the domestic insurance market in 18 OECD countries (table 3.6). For these countries, foreign companies' share of total written premiums ranges from 94 percent in Slovakia to 3 percent in Korea.³³ As a general rule, countries with small insurance markets (as measured by gross premiums) are likely to have higher levels of foreign market penetration due to the lack of globally competitive domestic insurers. In the United States, which is the world's largest insurance market, foreign companies account for a relatively small 9 percent of total premiums. One exception is the United Kingdom, where foreign firms accounted for 44 percent of the United Kingdom's gross premiums in 2006, likely due to London's role as a global center of underwriting activity for large and unusual risks. Most international insurance firms maintain operations in London, boosting foreign firms' overall share of the British market. By contrast, Korea ranks last in terms of foreign underwriting activity, reflecting the difficulties that foreign firms face in gaining entry to the Korean market.³⁴

TABLE 3.6 Market share of foreign companies in the domestic P&C market for direct insurance, 2006

Country	Market share of foreign companies		Gross premiums millions of \$
	%		
Slovakia	94		951
Czech Republic	92		3,289
Sweden	48		11,934
Luxembourg	48		1,270
United Kingdom	44		30,886
Norway	42		7,680
Austria	35		9,877
Canada	34		57,716
Portugal	33		5,192
Australia	24		17,870
Italy	24		48,266
Spain	21		25,035
Netherlands	20		37,184
Turkey	17		4,944
United States	9		809,054
Germany ^a	8		108,531
Japan	6		69,878
Korea ^a	3		30,987
Average market share for foreign companies	34		

Source: OECD, *Insurance Statistics Yearbook 1997–2006*, table 23, 2008, 53.

^aMarket share includes reinsurance. Separate data for direct insurance only are not available.

³³ OECD, *Insurance Statistics Yearbook 1997–2006*, table 23, 2008, 53.

³⁴ USTR, "Korea," 2008. The pending bilateral free trade agreement (FTA) between the United States and Korea addresses insurance in the FTA's financial services chapter. If the FTA enters into force, it is expected to generate a substantial increase in U.S. exports of insurance services to Korea. See USITC, *U.S.-Korea Free Trade Agreement*, 2007, 4–8.

Historically, foreign firms have also faced difficulties accessing Japan's domestic insurance market.³⁵

Trends in Reinsurance Trade

The reinsurance industry is integrated into a single worldwide market, with many of the largest reinsurance firms based in Bermuda, Germany, and Switzerland. Given the global nature of the reinsurance market, international trade in such services is in most cases a requirement to access customers around the world. Indeed, insurance companies worldwide rely heavily on access to a large capital pool controlled by foreign-based reinsurers.³⁶ Overall, the reinsurance business is not as closely regulated as other segments of the P&C insurance market, largely because insurance companies are assumed to be sophisticated consumers less in need of regulatory protection than individual consumers, or even business consumers, of primary insurance. For this reason, many of the regulatory restrictions that act as barriers to trade in P&C insurance services, both personal and commercial lines, do not affect reinsurance services to a large degree.³⁷ Trade in reinsurance is principally visible in cross-border trade statistics, largely because U.S. government and OECD affiliate trade data do not separate reinsurance from primary insurance.

U.S. Cross-border Trade in Reinsurance Services

Table 3.7 illustrates the share of reinsurance in overall U.S. imports and exports of cross-border insurance services, compared with trade in primary insurance. U.S. exports of reinsurance services reached \$6.3 billion in 2007, compared with imports of \$36.9 billion (table 3.7). Reinsurance accounted for 61 percent of total U.S. cross-border insurance exports in 2007, and 86 percent of total imports.

From 2000 through 2007, U.S. cross-border exports of reinsurance grew at a compound annual growth rate of approximately 11 percent, compared with import growth of 21 percent. Such rapid growth of U.S. imports of insurance services is due in large part to U.S. companies' increasing reliance on reinsurance services provided by companies based in Bermuda.³⁸ Overall, U.S. imports of reinsurance services exceeded U.S. exports by a wide margin from 2000 through 2007, mainly because most of the world's largest reinsurance firms are located outside the United States.

³⁵ USTR, "Japan" 2008.

³⁶ One of the few economic studies to directly address trade in insurance services bolsters this argument. Li, Moshirian, and Sim (2003) present evidence that increased foreign direct investment by U.S. firms in insurance is correlated with increased intra-industry trade in insurance services. The authors do not address whether such intra-industry trade involves direct insurance or reinsurance, since the largest share of cross-border insurance trade is reinsurance. However, it appears that firms that establish foreign affiliates in small markets turn to global reinsurance markets to reinsure their risks. Li, Moshirian, and Sim, "The Determinants of Intra-Industry Trade," 2003.

³⁷ USITC, Hearing transcript, September 23, 2008, 138-39 (testimony of George M. Brady on behalf of National Association of Insurance Commissioners).

³⁸ Industry representative, interview by Commission staff, New York, NY, November 19, 2008.

TABLE 3.7 U.S. cross-border trade in insurance services, 2000–2007

Trade	2000	2001	2002	2003	2004	2005	2006	2007	CAGR ^a (%)
U.S. exports									
Total (Millions of \$)	3,631	3,423	4,415	5,974	7,314	7,787	9,276	10,286	16
Reinsurance (Millions of \$)	3,039	2,727	3,339	4,381	4,742	4,275	5,541	6,275	11
Primary (Millions of \$)	592	697	1,077	1,593	2,571	3,511	3,735	4,012	31
Reinsurance/total (%)	84	80	76	73	65	55	60	61	(^b)
Primary/total (%)	16	20	24	27	35	45	40	39	(^b)
U.S. imports									
Total (Millions of \$)	11,284	16,706	21,926	25,234	29,090	28,540	33,582	42,761	21
Reinsurance (Millions of \$)	9,599	14,513	17,729	21,076	25,280	25,133	30,388	36,883	21
Primary (Millions of \$)	1,685	2,193	4,199	4,158	3,808	3,406	3,193	5,878	20
Reinsurance/total (%)	85	87	81	84	87	88	90	86	(^b)
Primary/total (%)	15	13	19	16	13	12	10	14	(^b)

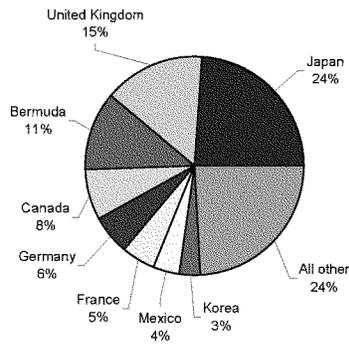
Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade 1986–2007," table 5: Insurance, undated (accessed July 21, 2008, and January 1, 2009).

^aCompound annual growth rate.

^bNot applicable.

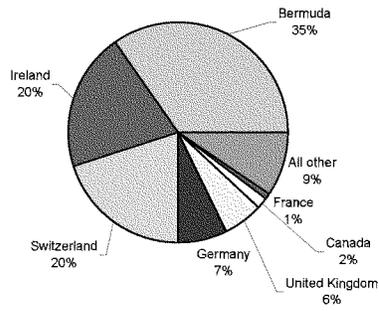
In 2007, 76 percent of U.S. cross-border exports of reinsurance services were concentrated in only eight countries. Overall, the largest market for U.S. reinsurance exports was Japan, which accounted for 24 percent of the total in 2007, followed by the United Kingdom (15 percent) and Bermuda (11 percent) (figure 3.7). In 2007, U.S. reinsurance imports were even more highly concentrated than exports, reflecting the dominance of reinsurance companies based in Bermuda, Ireland, and Switzerland, which together accounted for 75 percent of total cross-border imports of reinsurance services (figure 3.8). From 2000 through 2007, Bermuda was by far the largest source of U.S. reinsurance imports. During this period, Ireland and Switzerland both moved ahead of the United Kingdom as the second- and third-largest sources of U.S. reinsurance imports, respectively. Ireland's growth as a reinsurance center is a result of the Irish government's efforts to attract financial services firms to Dublin (box 3.3), while companies based in Switzerland have been major players in global reinsurance markets for decades.

FIGURE 3.7 Destinations for U.S. cross-border exports of reinsurance services, 2007



Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," table 6.2, October 2008.

FIGURE 3.8 Sources of U.S. cross-border imports of reinsurance services, 2007



Source: USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," table 6.2, October 2008.

CHAPTER 4

Market Access and Competitive Conditions

Identification of Measures Affecting Trade in Insurance Services

The focus of this chapter is on policies and practices that affect market access and competition (hereafter nontariff measures, or NTMs). While there may be examples of policies and practices that have a positive or neutral effect on market access and competition, the focus here is on those that adversely affect market access and competition. As demonstrated by the quantitative work presented later in this chapter, NTMs have a substantial effect on profits and trade.

In identifying NTMs, the Commission drew from literature developed by academics and industry representatives, in particular the Financial Leaders Working Group. The FLWG represents companies and industry associations across the financial services industry, including banking, insurance, insurance intermediation, asset management, securities, and pensions. The group's membership is drawn from companies and associations located in Australia, Canada, Hong Kong, Japan, Switzerland, and the United States, as well as EU member countries.^{1,2} As such, the FLWG does not represent the views of any one firm or country. Drawing principally from this group's model schedule and list of best practices, the Commission identified 11 NTMs that P&C insurance firms may encounter as they attempt to trade with, or invest in, foreign markets.

The FLWG does not include representatives from all developed countries or any developing countries, and therefore, it may not fully represent the perspectives of these countries regarding NTMs. More specifically, some countries may not agree as to whether the measures identified by the FLWG are intended principally to limit trade or to ensure the safety and soundness of the insurance market. There are divergent opinions regarding what constitutes so-called prudential regulations, intended to ensure stability and protect consumers.³ Consequently, the discussion that follows principally addresses the trade limiting aspects of the 11 NTMs identified by the FLWG, but recognizes that there are different ways to define prudential measures.

Studies examining services NTMs employ various methods of identifying countries which maintain impediments to trade. Several analyses have used WTO members' GATS commitments as a sole or key source of information on services barriers. For example, both the Pacific Economic Cooperation Council (1995) and Hoekman (1995, 1996) built frequency ratios based on the number of GATS commitments scheduled by individual WTO member countries in order to assess the relative level of liberalization offered in

¹ FLWG, "Financial Leaders Group Calls Further Financial Services Liberalization Essential," February 10, 2006.

² EU countries typically apply insurance regulation on a country-by-country basis.

³ USITC, Hearing transcript, September 23, 2008, 143 (testimony of George M. Brady, NAIC).

these commitments.⁴ Similarly, McGuire and Schuele (2000) used GATS commitments and other information to assess the restrictiveness of measures affecting the financial services sector in various countries. GATS commitments are frequently used as a source of information on services barriers because they are available for a large number of countries; offer largely standardized language regarding NTMs, facilitating cross-country comparisons; and represent legally binding levels of openness, enabling analyses of trade agreements. However, GATS commitments may misrepresent the relative restrictiveness of some countries' services measures, as most commitments are more than 10 years old and often represent an upper bound, meaning that actual policies are often more liberal than a country's commitments might suggest. A recent survey estimates that, on average, the measures identified in WTO member countries' GATS commitments are 84 percent more limiting than these countries' current practices.⁵

The Commission conducted extensive primary and secondary research⁶ to assess the degree to which the insurance regulations of 72 countries are in line with best practices set forth in the model insurance schedule developed by the FLWG.⁷ The model schedule includes nine policies that foster competition by permitting foreign access to P&C insurance markets, and two types of provisions that accord national treatment in those markets. Derogations from the model schedule are interpreted as NTMs.⁸

Market access provisions specified in the model schedule include

- the ability to supply MAT insurance on a cross-border basis (cross-border supply) (box 3.1);
- the ability of consumers to purchase MAT insurance from overseas vendors that have not registered in the consumers' home market (consumption abroad);
- the ability of foreign firms to determine their form of establishment in overseas markets;
- the ability of foreign firms to determine the extent of their equity participation in an overseas insurance entity;
- the gradual elimination of restrictions on foreign equity participation;

⁴ Mattoo, Stern, and Zanini, eds., *A Handbook of International Trade in Services*, 2008, 186.

⁵ Gootiz and Mattoo, "Services in Doha?" August 5, 2008.

⁶ Primary research includes interviews with representatives from P&C insurance firms and industry associations, academics noted in this area of research, and the Commission's public hearing on this investigation. In addition, the Commission conducted e-mail communications with foreign regulatory authorities, often in concert with U.S. Chambers of Commerce abroad, the U.S. State Department, the U.S. Foreign Commercial Service, foreign industry associations, and foreign missions in the United States. Prominent sources of secondary research include AXCO country reports, Standard & Poor's, the Economist Intelligence Unit, the OECD Product Market Regulation Database, reports published by the Financial Leaders Working Group, U.S. Foreign Commercial Service country commercial guides, the U.S. Trade Representative's National Trade Estimate report, foreign legislation, and journal articles accessed through JSTOR and the Social Sciences Research Network. Country and industry association Web sites were also used in the Commission's secondary research efforts.

⁷ This model schedule was adopted by the Financial Leaders Group and its Working Group in 2001 for the purpose of guiding the development of individual countries' GATS commitments on insurance services. The Financial Leaders Group, which was established in 1996 and represents several of the world's largest financial services associations and firms, promotes efforts to achieve financial services liberalization through the WTO. CSI, Written submission to the USITC, October 7, 2008, 3; FLWG, "Financial Leaders Group Calls Further Financial Services Liberalization Essential," February 10, 2006.

⁸ NTMs identified by the Commission are very similar to those identified by other researchers. See, for instance, Deihl and Sheppard, "Modal Estimates of Services Barriers: Annex 1," November 8, 2005; and Dee, "A Compendium of Barriers to Trade in Services," November 2005.

- the absence of restrictions or discriminatory measures affecting foreign provision of compulsory insurance;
- the elimination of monopolies and other exclusive suppliers of insurance services;
- the ability of foreign firms to choose the individual(s) that serve as their overseas representative(s);
- the availability of visas and work permits for service suppliers that enter a foreign market on a temporary basis.

The schedule's national treatment provisions include

- foreign firms' ability to supply insurance services to entities that are owned by, or affiliated with, the government;
- the application of identical capital solvency requirements for both foreign and domestic insurance enterprises.

An inventory of NTMs based on the insurance industry's model schedule offers several benefits when conducting assessments of such NTMs. First, unlike the measures scheduled by WTO member countries when they acceded to the GATS, the measures identified in the model schedule are currently in force. The use of the model schedule also allows a focus on measures that industry representatives believe have the greatest effect on insurance firms' ability to export and operate in foreign markets. The value of industry input in developing trade restrictiveness indices is stressed by Deardorff and Stern, who argue that industry expertise is necessary to identify measures that impact the provision of a particular service, and to distinguish measures with a valid regulatory purpose from measures that primarily restrict trade.⁹ Further, the model schedule was the basis of an industry effort to create an inventory of NTMs in foreign countries. As a result, a relatively significant amount of information has been collected on the measures identified in the model schedule. In creating the inventory used in the following analyses, the Commission updated, verified, and added new information to the industry's database, creating an inventory with more complete information on individual countries, and extending the inventory's coverage from 46 to 72 countries (table 4.1).¹⁰ This inventory is the basis of the analyses below, and of the insurance trade restrictiveness index, ITRI, presented later in this chapter.

⁹ Deardorff and Stern, "Empirical Analysis of Barriers to International Services Transactions," 2008, 185.

¹⁰ The Commission collected NTM-related information on 72 countries: Argentina, Australia, Austria, Bangladesh, Barbados, Belgium, Bolivia, Brazil, Bulgaria, Canada, Chile, China, Colombia, Croatia, Czech Republic, Denmark, Ecuador, Egypt, Estonia, Finland, France, Germany, Greece, Guatemala, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Jordan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Mexico, Morocco, the Netherlands, New Zealand, Norway, Pakistan, Panama, Peru, the Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, Turkey, Ukraine, United Arab Emirates, United Kingdom, United States, Venezuela, and Vietnam.

TABLE 4.1 Countries with derogations from the model schedule

Country	Market Access Provisions					National Treatment Provisions			
	Access to MAT insurance on a cross-border basis is permitted without regard to registration	Freedom to establish in the form of firm's choice	Freedom from equity limitations and staged elimination where they exist	Absence of restrictions or discriminatory measures affecting foreign provision of compulsory lines	Elimination of monopolies and other exclusive suppliers of insurance services	Ability of insurance firms to select their own representatives in the host country	Provision of visas and work permits for short periods of stay	Ability to supply insurance services to entities owned or affiliated with the government	Application of identical capital, solvency, reserve, tax, and other financial requirements, subject to the prudential carve out
Argentina	X	X			X			X	X
Australia	X	X		X	X				
Austria	X	X		X	X			X	X
Bangladesh	X	X		X	X			X	X
Barbados	X	X		X	X				
Belgium									
Bolivia	X	X			X				X
Brazil	X	X			X				X
Bulgaria	X	X			X				X
Canada				X	X			X	X
Chile	X	X			X			X	X
China		X		X	X			X	X
Colombia	X	X			X				
Croatia	X	X			X				
Czech Republic	X	X			X				
Denmark									X
Ecuador									
Egypt	X	X			X				
Estonia	X	X							
Finland		X							X
France		X							
Germany	X	X							
Greece									
Guatemala	X	X							X
Hong Kong	X	X							
Hungary	X	X							
Iceland	X	X							
India	X	X		X				X	X
Indonesia	X	X		X				X	X
Ireland	X	X							
Israel		X							

TABLE 4.1 Countries with derogations from the model schedule—Continued

Country	Market Access Provisions						National Treatment Provisions		
	MAT insurance permitted on a cross-border basis	Access to MAT insurance on a cross-border basis is permitted without regard to registration	Freedom to establish in the form of firms choice	Freedom from equity limitations and staged elimination where they exist	Absence of restrictions or discriminatory measures affecting foreign provision of compulsory lines	Elimination of monopolies and other exclusive suppliers of insurance services	Ability of insurance firms to select their own representatives in the host country	Provision of visas and work permits for short periods of stay	Ability to provide insurance services to entities owned or affiliated with the government
Italy	X	X	X	X	X	X		X	X
Japan	X	X	X			X			X
Jordan	X	X	X	X					
Kenya	X	X	X	X	X	X	X	X	X
Korea	X	X	X	X	X	X	X	X	X
Latvia	X	X	X						
Lithuania	X	X	X						
Luxembourg	X	X	X	X	X	X	X	X	X
Malaysia	X	X	X	X	X	X	X	X	X
Malta	X	X	X	X	X	X		X	X
Mexico	X	X	X	X	X	X		X	X
Morocco	X	X	X	X	X	X		X	X
Netherlands	X	X	X				X		X
New Zealand	X	X	X	X	X	X		X	X
Norway	X	X	X			X		X	X
Pakistan	X	X	X	X		X		X	X
Panama	X	X	X						
Peru	X	X	X				X		X
Philippines	X	X	X			X		X	X
Poland	X	X	X	X		X	X	X	X
Portugal	X	X	X			X		X	X
Romania	X	X	X				X		X
Russia	X	X	X	X	X	X	X	X	X
Saudi Arabia	X	X	X	X	X	X	X	X	X
Singapore	X	X	X						
Slovakia	X	X	X						
Slovenia	X	X	X			X			X
South Africa	X	X	X	X			X		X
Spain	X	X	X						
Sri Lanka	X	X	X						X
Sweden	X	X	X						X

TABLE 4.1 Countries with derogations from the model schedule—Continued

Country	Market Access Provisions						National Treatment Provisions		
	Access to MAT insurance on a cross-border basis is permitted without regard to registration	Freedom to establish in the form of firm's choice	Freedom from equity limitations and staged elimination where they exist	Absence of restrictions or discriminatory measures affecting foreign provision of compulsory lines	Elimination of monopolies and other exclusive suppliers of insurance services	Ability of insurance firms to select their own representatives in the host country	Provision of visas and work permits for short periods of stay	Ability to supply insurance services to entities owned or affiliated with the government	Application of identical capital, solvency, reserve, tax, and other financial requirements, subject to the prudential carve out
Switzerland	X								
Thailand	X	X	X	X	X	X	X	X	X
Tunisia	X	X	X		X	X	X		
Turkey	X	X	X	X		X			
Ukraine	X	X							
United Arab Emirates	X	X	X		X	X	X	X	X
United Kingdom									
Venezuela	X	X	X	X	X	X	X	X	X
Vietnam	X	X	X	X	X	X	X	X	X

Source: Compiled by Commission staff from industry interviews, country and industry reports, and electronic databases.

Note: As noted, this inventory of derogation from the model schedule is the result of intensive research using primary and secondary sources. As in all research of this nature, it was occasionally necessary to make inferences from the best available information.

Summary of Market Access and National Treatment NTMs

Limitations on the cross-border provision of MAT insurance: Commission staff analyzed insurance-related NTMs for 65 countries. This research indicates that limitations on the cross-border provision of MAT insurance are relatively common. Approximately three-quarters of the focus countries maintain some restriction on cross-border MAT insurance, with such provisions found in both developed and developing markets. For example, countries such as Brazil, Bulgaria, Colombia, Indonesia, Russia, and Switzerland appear to prohibit all forms of cross-border trade in MAT insurance. Some focus countries limit the cross-border supply of MAT insurance to certain lines (such as marine export insurance in Bangladesh) or certain providers (such as EU-based providers in Hungary). In Germany, Norway, Singapore, and South Africa, the cross-border provision of insurance coverage may be permitted in buyer-initiated transactions. Other countries subject the cross-border supply of MAT insurance to an economic needs test, or do not guarantee or commit to an open market for cross-border MAT insurance.

Restrictions on the purchase of MAT insurance abroad: Similarly, approximately 80 percent of the focus countries effectively restrict their residents' ability to purchase MAT insurance abroad, either through an outright ban on some or all such transactions, or by imposing measures such as registration, approval, or commercial presence requirements on foreign insurance suppliers. For example, Argentina, Bolivia, Colombia, Hong Kong, Italy, Korea, Malaysia, Pakistan, the Philippines, Singapore, Turkey, and Venezuela require that insurance firms establish a presence in their countries, register, and/or obtain some type of approval in order to provide insurance coverage to customers. Chile imposes a 22 percent tax on MAT insurance coverage that is purchased abroad. Much like cross-border MAT insurance transactions, consumers' ability to purchase MAT insurance abroad also is limited by economic needs tests and a lack of bilateral or multilateral trade commitments in several countries.

Limitations of form of establishment: To remain competitive in varying cultural and regulatory environments, insurance firms often provide insurance services to overseas clients through local affiliates.¹¹ The ability to establish branch offices can be particularly critical, as branches have access to both local and home-office capital.¹² Measures affecting the manner in which a foreign firm may set up operations in an overseas market are particularly common; 60 percent of the focus countries maintain provisions that limit a firm's ability to determine its form of establishment. For example, a number of countries—namely Argentina, Brazil, Chile, China, Colombia, Egypt, Guatemala, Indonesia, India, Mexico, Malaysia, Saudi Arabia, Singapore, South Africa, Sri Lanka, Thailand, Venezuela, and Vietnam—prohibit or restrict the establishment of branch offices. Further, the establishment or operation of a commercial presence by a foreign

¹¹ Ma and Pope, "Determinants of International Insurers' Participation," 2003, 235-48.

¹² CSI, written submission to the USITC, October 7, 2008, 2.

insurer may be subject to approval in several countries, including Brazil, Germany, Italy, Russia, Singapore, Thailand, Turkey, and Venezuela.

Limitations on foreign shareholding in an insurance firm: Commission research also indicates that at least half of the focus countries maintain limitations on the share of foreign equity in an insurance entity. Several countries, including China, India, Mexico, Malaysia, Russia, and Vietnam, have established specific percentage limits for foreign shareholding in insurance entities. Similarly, Egypt, Indonesia, Ireland, South Africa, Thailand, and Turkey require a foreign investor to secure approval when its equity stake in an insurance enterprise exceeds a certain threshold. Among this report's focus countries, only Korea has liberalized provisions regarding foreign equity holdings in recent years. One industry representative reports that a firm's ability to determine its equity holding in a foreign enterprise is critical; investors may be less willing to contribute capital or expertise to an enterprise in which they hold a minority interest, as it may be unclear who will benefit from those investments.¹³

Restrictions on the provision of compulsory insurance: Over one-quarter of the focus countries maintain measures affecting foreign firms' ability to provide compulsory insurance coverage, which may include, for example, third-party motor vehicle insurance. Many U.S. P&C insurance companies note, in particular, that non-Chinese insurance companies are not allowed to offer third-party automobile liability insurance in China.¹⁴ In Australia and Canada, the provision of third-party auto insurance is reserved for a monopoly provider in certain states or provinces. In Italy, auto insurers must offer all categories of insurance, Japan requires that firms providing such insurance receive approval, Lithuania requires providers of compulsory auto insurance to secure membership in the Motor Bureau, and Vietnam completely bars foreign firms from providing third-party auto liability insurance. Other compulsory insurance markets that are not open to foreign participation include Vietnam's construction insurance market and Norway's fire insurance pool.

Presence of monopoly providers: No less than 30 percent of the focus countries retain measures regarding the monopoly provision of all, or certain types, of P&C insurance. Types of insurance coverage that are reserved for monopoly providers—either completely or in certain jurisdictions or industries—include third-party auto insurance (Australia and Canada), workers' compensation insurance (Australia, Brazil, and Switzerland), and natural damage and fire insurance (Switzerland), among others. In certain countries, the postal system acts as a public insurance monopoly and may benefit from less stringent regulatory requirements than those applied to its competitors.¹⁵ Recent developments have had some effect on postal firms' participation in insurance markets. Under the provisions of the U.S.-Korea Free Trade Agreement, for

¹³ USITC, Hearing transcript, September 23, 2008, 147 (testimony of Michael Moran on behalf of Council of Insurance Agents and Brokers); Moran, on behalf of the Council of Insurance Agents and Brokers, Written testimony to the USITC, September 23, 2008.

¹⁴ USITC, Hearing transcript, September 23, 2008, 13 (testimony of David Snyder, American Insurance Association; industry officials, interviews by Commission staff, August 14, 2008 and December 17, 2008).

¹⁵ USITC, Hearing transcript, September 23, 2008, 110–14 (testimony of David Snyder, American Insurance Association); Snyder, Written testimony to the USITC, September 23, 2008.

example, Korea Post will be subject to the same rules as private suppliers of insurance services.¹⁶ Further, Japan has begun the process of privatizing Japan Post, whose insurance activities largely are limited to the life insurance segment.¹⁷ At the same time, however, one industry representative reports concerns that Japan Post may use its growing private ownership as a rationale for entering the P&C insurance market while continuing to benefit from preferential treatment.¹⁸

Restrictions on the selection of key personnel and the entry of foreign workers: The availability of skilled and knowledgeable employees reportedly is critical to the success of insurance companies in overseas markets.¹⁹ Moreover, the transfer of key personnel also may benefit developing countries by facilitating the development of professional workforces to staff those countries' insurance companies.²⁰ At least 40 percent of the focus countries maintain measures affecting insurance firms' ability to select key personnel. For example, in both Brazil and Guatemala, firms with three or more employees are required to employ nationals to fill at least two-thirds of their positions. Russia, Thailand, Turkey, Venezuela, and South Africa have identified certain positions that must be filled—or a certain share of which must be filled—by nationals or permanent residents of the host country. Further, Saudi Arabia requires that Saudi citizens account for 30 percent of a firm's employees, while Singapore subjects work permits to firm-specific quotas, thus limiting the number of foreign personnel in a firm's overall workforce. Although most countries (including the United States) regulate the entry of foreign workers, it appears that at least 10 of the overseas markets investigated as part of this study maintain measures pertaining to the issuance of work permits and visas. For example, work permits are subject to quotas in Italy, Malaysia, and South Africa, while Thailand limits the number of permits available to individual firms based on firms' capital. Administrative factors act as barriers to the issuance of work permits in Indonesia, where obtaining a work permit entails numerous steps, and in Chile, which reportedly does not issue work permits and visas in a timely manner. Further, work permits cannot be obtained in Poland.

Restrictions on the foreign provision of insurance to state-owned or state affiliated enterprises: In addition to the market access measures summarized above, insurance companies also face provisions that may place them at a disadvantage relative to domestic insurers. For example, the ability of foreign firms to provide insurance coverage to enterprises that are affiliated with, or owned by, the state is limited in more than one-third of the focus countries. The coverage of all, or some, government entities is reserved for state-affiliated insurers in Norway,²¹ Pakistan, the Philippines, Saudi Arabia, and Thailand. Similarly, Argentina specifically prohibits the foreign provision of insurance

¹⁶ U.S.-Korea Free Trade Agreement, Annex 13-D.

¹⁷ USITC, Hearing transcript, September 23, 2008, 113-14 (testimony of David Snyder, American Insurance Association).

¹⁸ *Ibid.*

¹⁹ Hartwig, Insurance Information Institute, Written submission to the USITC, October 2, 2008, 7.

²⁰ UNCTAD, *Trade and Development Aspects of Insurance Services*, November 21, 2005, 26.

²¹ The state is the monopoly provider of war risk cargo insurance in Norway.

coverage for government-owned or -used goods. “Buy Canada” policies may put foreign insurers at a competitive disadvantage in certain Canadian provinces. Further, in some countries, foreign insurers face discrimination or are effectively barred from selling insurance to state entities despite the absence of a formal provision limiting such activities. Markets in which insurers confront these informal barriers reportedly include India, Indonesia, Korea, and Malaysia.

Discriminatory capital solvency requirements: Discriminatory capital solvency measures are particularly prevalent, as approximately 50 percent of the focus countries appear to apply unequal capital solvency requirements to domestic and foreign insurers. For example, Indonesia requires joint ventures to maintain Rp. 15 billion (or approximately \$1.2 million)²² in paid-up capital, while local insurance firms are required to hold only Rp. 3 billion (or approximately \$250,000). Portugal and Sweden impose different deposit requirements on non-EU members and non-European Economic Association countries. Some countries also maintain other types of measures that may have a discriminatory effect on foreign firms’ capital. These include discriminatory tax measures (such as those imposed in China, Pakistan, Peru, and Venezuela), and measures affecting capital remittances (such as those maintained by Brazil, Peru, Sri Lanka, and Thailand).

The Insurance Trade Restrictiveness Index

The Commission used its inventory of NTMs to develop an Insurance Trade Restrictiveness Index, or ITRI, which provides a numeric score for NTMs identified in 62 countries.²³ In particular, the Commission assigned one of three scores to each of the 11 practices found in the model schedule. For each practice, a score of 0 is applied if it is completely open (or permitted), whereas a score of 1 is assigned if it is completely closed (or prohibited). In many cases, practices are neither completely open nor prohibited. Such cases are classified as “other” and assigned a score of 0.5. The index was calculated as the average of these scores, with no weights applied to specific practices (figure 4.1). The Commission employs the ITRI in several econometric models designed to estimate the effect of NTMs.

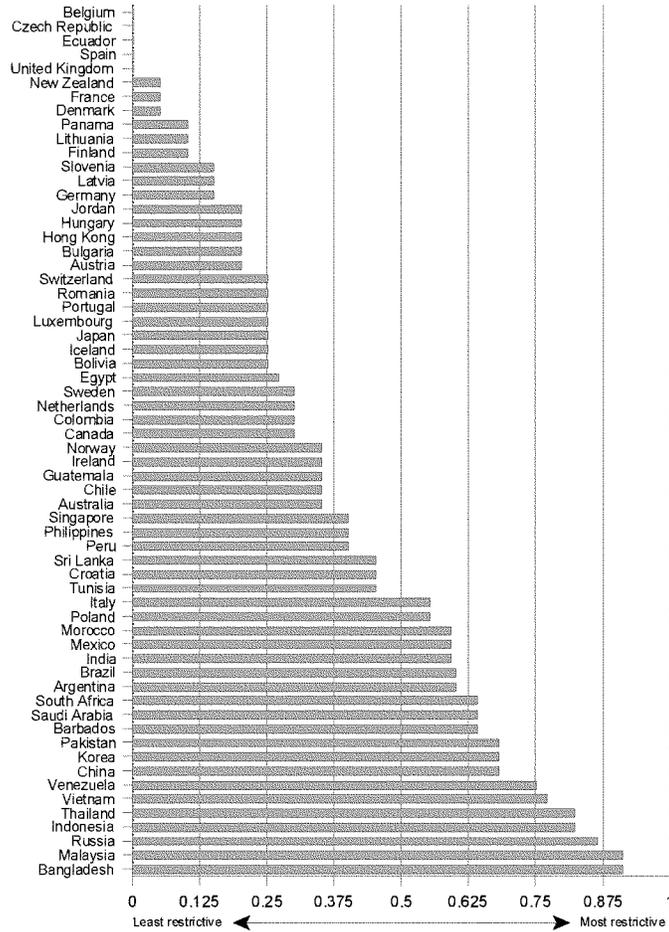
Effects of Liberalization

Commission research and academic literature offer some insight into the likely effects of removing NTMs on trade, economic development, profits, and employment. The trade, profit, and employment effects of liberalization were developed by the Commission, whereas the effects on economic growth drew on outside research. The immediate effects of liberalization could include market entry by foreign insurers, most likely as affiliate companies in the previously restricted retail insurance sector. Under such circumstances, the threat of

²² Based on a December 8, 2008, interbank exchange rate of \$1 to Rp. 12,121.2.
<http://www.oanda.com/>.

²³ The term trade restrictiveness index (TRI) is used by some economists in a different context. See Anderson and Neary, “A New Approach,” January 1996, 107–25; Irwin, “Trade Restrictiveness,” September 2007.

FIGURE 4.1 Insurance Trade Restrictiveness Index (ITRI), selected countries



Source: Compiled by Commission staff.

Note: The ITRI value for Belgium, Czech Republic, Ecuador, Spain, and the United Kingdom is zero.

increased competition from foreign insurance companies would likely motivate domestic insurance firms to improve operations. In general, as there would be more firms in the market and/or fewer trade restrictions, consumer prices and profit margins tend to fall to more competitive levels. Overall, the operation of foreign P&C insurance firms in open markets encourages the development of those markets by extending insurance to a larger share of the population.

Trade Effects

Commission research suggests that liberalizing foreign markets would result in a considerable increase in U.S. insurance exports. Econometric models developed by the Commission suggest that a 10 percent reduction in a country's restrictiveness would increase U.S. insurance exports by 9.9 percent (appendix E). For example, a 10 percent reduction in Mexico's restrictiveness in 2005 would have increased U.S. insurance exports to Mexico from \$27 million to approximately \$29.7 million.²⁴ If all countries in the Commission's sample were completely open, U.S. exports of insurance services could potentially increase by 48 percent, or \$870 million.²⁵

Commission models estimate that liberalization would produce a greater effect on the sales of foreign insurance affiliates owned by U.S. companies, the predominant form of trade in P&C insurance. Under these models, a 10 percent reduction in the ITRI would yield an estimated 14.5 percent increase in U.S.-owned insurance affiliates' sales. Again, in the case of Mexico, a 10 percent reduction in trade restrictiveness would have increased U.S.-owned affiliates' sales from \$4.8 billion²⁶ to approximately \$5.4 billion in 2005. Full liberalization by all countries in the Commission's sample could result in an estimated 28 percent increase in total U.S.-owned affiliates' sales, or \$39.1 billion.²⁷

Economic Development Effects

Industry experts have asserted that the development of the P&C insurance industry promotes economic growth and development through the economic functions the industry performs.²⁸ Such functions include risk pooling, thereby promoting long-term savings; signalling markets by electing to cover certain risks and not others; broadening and deepening financial and capital markets by investing reserves; reducing the financial uncertainty and volatility associated with noninsured losses; managing the liability exposure of individuals and firms when undertaking commercial activities; and using premium rates to encourage greater caution in individuals' and firms' assumption of risk.

These arguments find support, in varying degrees, in theoretic and empirical work. Holsboer (1999), for instance, attributes the connection between P&C

²⁴ USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2007," October 2008, 131. This figure includes life insurance as well as P&C, but excludes reinsurance.

²⁵ The export model includes data for 31 countries over the 2001–05 period. For more information regarding the model, see app. E.

²⁶ USDOC, BEA, "Financial and Operating Data (Nonbank) Interactive Tables," (accessed February 11, 2009).

²⁷ The affiliate sales model includes data for 34 countries over the 1999–2005 period.

²⁸ Skipper, Starr, and Robinson, "Liberalization of Insurance Markets," 2000, 10–13.

insurance penetration and economic growth to the effect of the insurance market on long-term savings and capital market development.²⁹ Catalan, Imparido, and Musalem (2000) find the same connection, attributing it to the intermediary function of P&C insurers, as well as their effect on capital market development.³⁰ Empirical econometric work that confirms the relationship between P&C insurance and economic growth includes Beenstock, Dickinson, and Khajuria (1988); Outreville (1990); Park, Borde, and Choi (2002);³¹ Arena (2006);³² and Vadlamannati (2007).³³

Profit Effects

The Commission measured the impact of NTMs on the adjusted profit margins of P&C insurance carriers, calculated as pretax profits per dollar of net premiums written. For the purposes of this report, the impacts of NTMs are called profit effects. The estimated profit effects are defined as the amount by which P&C insurers' adjusted profit margins³⁴ are inflated due to trade restrictions. Following existing literature in the area,³⁵ the Commission developed the profit effects by employing a two-stage econometric model (appendix F). In the first stage, profits per dollar premium, using data reported by more than 2,700 firms in over 60 countries, are regressed on independent variables representing firms' investment acumen, cost management skills, risk assessment skills, and risk exposure. Investment acumen is measured as the ratio of investment returns, including net interest income and other gains and losses reflecting capital gains, to funds invested, including net technical reserves and policyholders' surplus. Cost management skills are reflected in the expense ratio, which divides fees, commissions, and other operating expenses by net premiums written. Risk assessment is reflected in the loss ratio, which divides claims paid by net premiums earned. Risk exposure is calculated by dividing net premiums written by the surplus. Risk exposure is subject to prudential regulation intended to ensure that potential losses can be covered by firms' capital. Typically, regulators limit net premiums to three times the value of firms' capital, though self-

²⁹ Holsobar, "Repositioning of the Insurance Industry," 1999.

³⁰ Catalan, Imparido, and Musalem, "Contractual Savings or Stock Markets Development," 2000.

³¹ Beenstock, Dickson, and Khajuria, "The Relationship Between Property-Liability Insurance Penetration," 1998; Outreville, "The Economic Significance of Insurance Markets," 1990; and Park, Borde, and Choi, "Determinants of Insurance Pervasiveness," 2002.

³² Arena, "Does Insurance Market Activity Promote Economic Growth?" December 2006, 15-16.

³³ Vadlamannati, "Does Insurance Sector Growth and Reforms Effect Economic Development?" 2007, 52-53. There are other studies that do not find that insurance development promotes economic development, either generally or in specific countries, and still others that find evidence of the opposite dynamic, wherein economic growth promotes development of the P&C insurance industry. Throughout the literature, however, there is acknowledgement that both processes might occur simultaneously. It is for this reason, in part, that profits effects are estimated in two stages.

³⁴ Adjusted profit margins are "adjusted" for the effects on profit margins of firm-level variables such as loss ratios, expense ratios, risk exposure, and investment acumen. It is necessary to adjust the total profit margin for these firm-level effects in order to isolate the effects of country-level variables, including the ITRI.

³⁵ See, for instance, Kalirajan, et al., "The Price Impact of Restrictions in Banking Services," 2000, 215-30; McGuire, and Schuele, "Restrictiveness of International Trade in Banking Services," 2000; and Diehl and Shepard, "Modal Estimates of Services Barriers: Annex," October 27, 2005.

regulation by firms often reduces this multiple. Regression results for the first stage indicate that all independent variables are statistically significant at the 1 percent level and jointly explain about 51 percent of variation in the profit margin. The end result of this regression is an adjusted profit margin corrected for firm-level characteristics.

In the second stage, the adjusted profit margin is regressed on country-level institutional, market, and macroeconomic variables. The country-level institutional variables include the corruption perception index (CPI) and property rights index (PRI) developed by Transparency International and the Heritage Foundation, respectively. Due to correlation issues, these two variables appear in different model specifications. Market variables include the share of GDP exposed to risk, developed by the World Bank, and the combined market share of the top five P&C insurers in each market. Macroeconomic variables include the real interest rate, unemployment rate, and the ITRI, developed by the Commission and discussed previously. Regression results indicate that the ITRI, CPI, PRI, and GDP share exposed to risk variables are statistically significant, with the model explaining about 26 percent of variation in the adjusted profit margin. Algebraic manipulation of the ITRI and its coefficient yields the profit effects appearing in table 4.2.

Large profit effects suggest firms are able to extract higher profits than the amount they would command in an open trade environment. Many of the economies with larger profit effects are emerging markets, some of which have recently liberalized their insurance markets (e.g., India and Vietnam), but nonetheless retain significant restrictions. Countries with smaller profit effects are generally, but not exclusively, the developed economies of the OECD, many of which have few, if any, policy restrictions on foreign firms' market access and operations.

TABLE 4.2 Estimated profit effects in the P&C insurance industry

0 to 10 percent		11 to 20 percent	21 to 35 percent	Greater than 35 percent
Austria	Japan	Canada	Argentina	Bangladesh
Belgium	Jordan	Chile	Barbados	Indonesia
Bolivia	Latvia	Colombia	Brazil	Malaysia
Bulgaria	Lithuania	Croatia	China	Russia
Czech Republic	Luxembourg	Guatemala	India	Thailand
Denmark	New Zealand	Ireland	Italy	Venezuela
Ecuador	Panama	Netherlands	Korea	Vietnam
Egypt	Portugal	Norway	Mexico	
Finland	Romania	Peru	Morocco	
France	Slovenia	Philippines	Pakistan	
Germany	Spain	Singapore	Poland	
Hong Kong	Switzerland	Sri Lanka	Saudi Arabia	
Hungary	United Kingdom	Sweden	South Africa	
Iceland		Tunisia		

Source: Compiled by Commission staff.

Notes: The estimated profit effects are the amount by which P&C insurers' adjusted profit margins are inflated due to trade restrictions. Adjusted profit margins are "adjusted" for the effects on total profit margins of firm-level variables, such as loss ratios, expense ratios, risk exposure, and investment acumen. It is necessary to adjust the total profit margin for the effects of firm-level variables in the first stage so that the effects of country-level variables, including the ITRI, can be isolated in the second stage.

Employment Effects

Commission analysis also suggests that full liberalization of foreign P&C insurance markets would increase employment among firms in the U.S. insurance industry. Building upon traditional gravity models used to estimate the trade effects of liberalization, the Commission developed a partial equilibrium model. The partial equilibrium model focused on three geographic markets and the effect of liberalization on labor, capital, and other inputs. The Commission's model suggests that foreign liberalization would result in increased cross-border exports; the establishment of more foreign affiliates, which would require more support services from their U.S. headquarters; and growth among the U.S. affiliates of foreign firms as they exit markets newly occupied by U.S.-owned affiliates. In combination, these effects would ultimately increase P&C insurance employment in the United States by an estimated 0.72 percent. This would mean that, on average, an insurance firm with 10,000³⁶ employees would increase employment by approximately 72 workers.³⁷ These effects are consistent with information obtained in industry interviews. For example, one representative stated that if affiliate profits were returned to the home office, and the home office used those profits as capital with which to write new policies, additional employment could likely result.³⁸ Another industry representative indicated that, although many functions performed by foreign insurance affiliates need to take place in the host-country market, insurance firms typically prefer to centralize certain operations at U.S.-based headquarters. Such operations include corporate investment and certain data-processing operations, as well as tasks associated with the coordination of affiliates located in multiple countries.³⁹

³⁶ This example is provided for illustrative purposes only.

³⁷ Brady, et al., *Property and Casualty Insurance Services: Foreign Market Liberalization Effects on Labor*, forthcoming.

³⁸ Industry representative, telephone interview by Commission staff, December 2, 2008.

³⁹ J. David Cummins, interview by Commission staff, Philadelphia, PA, December 5, 2008.

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APPENDIX A
REQUEST LETTER

EXECUTIVE OFFICE OF THE PRESIDENT
THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON, D.C. 20508

The Honorable Daniel R. Pearson
Chairman
U.S. International Trade Commission
500 E Street, SW
Washington DC, 20436

DOCKET NUMBER
2621
Office of the Secretary Int'l Trade Commission

JUN 09 2008

Dear Chairman Pearson:

As you are aware, the United States actively encourages the global liberalization of services markets. The liberalization of financial service markets, in particular, is among our highest priorities as it has been shown that financial liberalization promotes more efficient and effective capital allocation, intermediation, and risk management, which in turn promote economic growth and prosperity in both developed and developing countries. A report on property-casualty insurance markets would be helpful as background information for discussions taking place in the WTO and other trade fora.

Therefore, I request, pursuant to authority delegated by the President under section 332(g) of the Tariff Act of 1930, that the U.S. International Trade Commission conduct an investigation and prepare a report that, to the extent possible; (1) provides an overview of global and selected foreign markets for property/casualty insurance services, including factors affecting supply and demand in these markets; (2) examines the nature and extent of cross-border trade and affiliate sales in the global market for property/casualty insurance services; and (3) identifies and examines policies and practices that affect U.S. firms' access to, and competitiveness in, foreign markets for such services. With regard to the geographic coverage of this report, the Commission should include examples from both developed- and developing-country markets.

The Commission is requested to deliver its report no later than nine months from the receipt of this request. After review and discussion, we intend to make the Commission's report available to the general public in its entirety. Therefore, the report should not contain any confidential business or national security classified information.

The Commission's assistance in this matter is greatly appreciated.

Sincerely,

Susan C. Schwab

RECEIVED
OFFICE OF THE SECRETARY
U.S. INTERNATIONAL TRADE COMMISSION
2008 JUN 18 PM 3:28

APPENDIX B
FEDERAL REGISTER NOTICE

UNITED STATES INTERNATIONAL TRADE COMMISSION
Washington, D.C. 20436

Investigation No. 332-499

Property and Casualty Insurance Services: Competitive Conditions In Foreign Markets

AGENCY: United States International Trade Commission.

ACTION: Institution of investigation and scheduling of hearing.

SUMMARY: Following receipt of a request on June 18, 2008 from the Office of the United States Trade Representative (USTR), the U.S. International Trade Commission (Commission) instituted investigation No. 332-499, *Property and Casualty Insurance Services: Competitive Conditions in Foreign Markets*, under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)).

IMPORTANT DATES:

September 2, 2008	Deadline for filing requests to appear at the public hearing.
September 5, 2008	Deadline for filing pre-hearing briefs and statements.
September 23, 2008	Public hearing.
September 30, 2008	Deadline for filing post-hearing briefs and submissions.
October 7, 2008	Deadline for filing all other written statements.
March 18, 2009	Transmittal of final report to the Office of the U.S. Trade Representative

ADDRESSES: All Commission offices, including the Commission's hearing rooms, are located in the United States International Trade Commission Building, 500 E Street S.W., Washington, D.C. All written submissions should be addressed to the Secretary, United States International Trade Commission, 500 E Street S.W., Washington, D.C. 20436. The public record for this investigation may be viewed on the Commission's electronic docket (EDIS) at <http://www.usitc.gov/secretary/edis.htm>.

FOR FURTHER INFORMATION CONTACT: Project Leader Eric Forden (202-205-3235 or eric.forden@usitc.gov), Deputy Project Leader Jeremy Wise (202-205-3190 or jeremy.wise@usitc.gov), or Chief, Services Division, Richard Brown (202-205-3438 or richard.brown@usitc.gov) for information specific to this investigation. For information on the legal aspects of this investigation, contact William Gearhart of the Commission's Office of the General Counsel (202-205-3091 or william.gearhart@usitc.gov). The media should contact Margaret O'Laughlin, Office of External Relations (202-205-1819 or margaret.olaughlin@usitc.gov). Hearing-impaired individuals may obtain information on this matter by contacting the Commission's TDD terminal at 202-205-1810. General information concerning the Commission may also be obtained by accessing its Internet site (<http://www.usitc.gov>). Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Office of the Secretary at 202-205-2000.

BACKGROUND: As requested by the USTR, the Commission will conduct an investigation and prepare a report on property and casualty (P&C) insurance markets that (1) provides an overview of global and selected foreign markets for P&C insurance services, including factors affecting supply and demand in these markets; (2) examines the nature and extent of cross-border trade and affiliate sales in the global market for P&C insurance services; and (3) identifies and examines policies and practices that affect U.S. firms' access to, and competitiveness in, foreign markets for such services. In terms of geographic coverage, the USTR has requested that the Commission include examples of both developed- and developing-country markets. The USTR requested that the Commission deliver its report by March 18, 2009.

PUBLIC HEARING: A public hearing in connection with this investigation will be held at the U.S. International Trade Commission Building, 500 E Street SW, Washington, DC, beginning at 9:30 a.m. on September 23, 2008. Requests to appear at the public hearing should be filed with the Secretary, no later than 5:15 p.m., September 2, 2008, in accordance with the requirements in the "Submissions" section below. All pre-hearing briefs and statements should be filed no later than 5:15 p.m., September 5, 2008; and all post-hearing briefs and statements should be filed no later than 5:15 p.m., September 30, 2008. In the event that, as of the close of business on September 2, 2008, no witnesses are scheduled to appear at the hearing, the hearing will be canceled. Any person interested in attending the hearing as an observer or nonparticipant may call the Secretary to the Commission (202-205-2000) after September 2, 2008, for information concerning whether the hearing will be held.

WRITTEN SUBMISSIONS: In lieu of or in addition to participating in the hearing, interested parties are invited to submit written statements concerning this investigation. All written submissions should be addressed to the Secretary, and should be received no later than 5:15 p.m., October 7, 2008. All written submissions must conform with the provisions of section 201.8 of the Commission's *Rules of Practice and Procedure* (19 C.F.R. 201.8). Section 201.8 requires that a signed original (or a copy so designated) and fourteen (14) copies of each document be filed. In the event that confidential treatment of a document is requested, at least four (4) additional copies must be filed, in which the confidential information must be deleted (see the following paragraph for further information regarding confidential business information). The Commission's rules authorize filing submissions with the Secretary by facsimile or electronic means only to the extent permitted by section 201.8 of the rules (see *Handbook for Electronic Filing Procedures*, http://www.usitc.gov/secretary/fed_reg_notices/rules/documents/handbook_on_electronic_filing.pdf). Persons with questions regarding electronic filing should contact the Secretary (202-205-2000).

Any submissions that contain confidential business information must also conform with the requirements of section 201.6 of the Commission's *Rules of Practice and Procedure* (19 C.F.R. 201.6). Section 201.6 of the rules requires that the cover of the document and the individual pages be clearly marked as to whether they are the "confidential" or "non-confidential" version, and that the confidential business information be clearly identified by means of brackets. All written submissions, except for confidential business information, will be made available for inspection by interested parties.

In its request letter, the USTR stated that it intends to make the Commission's report available to the public in its entirety. As a result, the Commission will not include any confidential business information or national security classified information in the report it sends to the USTR. Any confidential business information received by the Commission during the course of this investigation and used in preparing this report will not be published in a manner that would reveal the identities of individuals or companies supplying such information.

By order of the Commission.

/s/
William R. Bishop
Acting Secretary to the Commission

Issued: August 13, 2008

APPENDIX C
HEARING PARTICIPANTS

CALENDAR OF PUBLIC HEARING

Those listed below appeared as witnesses at the United States International Trade Commission's hearing:

Subject: Property and Casualty Insurance Services:
Competitive Conditions in Foreign Markets

Inv. No.: 332-499

Date and Time: September 23, 2008 - 9:30 a.m.

Sessions were held in connection with this investigation in the Main Hearing Room (room 101), 500 E Street, S.W., Washington, D.C.

ORGANIZATION AND WITNESS:

American Insurance Association
Washington, D.C.

David F. Snyder, Vice President and Assistant
General Counsel

National Association of Insurance Commissioners
Washington, D.C.

George M. Brady, Senior International Policy
Analyst and Counsel

Property Casualty Insurers Association of America
Des Plaines, IL

Robert Gordon, Senior Vice President, Policy
Development and Research

Stephen W. Broadie, Vice President, Financial
Legislation and Regulation

The Council of Insurance Agents & Brokers
Washington, D.C.

Michael Moran, Executive Vice President,
Aon Risk Services

Sara G. Andrews, Director, Global Strategy,
Aon Risk Services

APPENDIX D
BIVARIATE MODEL RESULTS

TABLE D.1 Bivariate linear regression results corresponding to figures 2.1, 2.2, and 2.4

	Figure 2.1 Insurance Density	Figure 2.2 Insurance Penetration	Figure 2.4 Growth of P&C premiums
Per capita income	0.023* (0.000)	0.000* (0.000)	
Per capita income growth			1.016* (0.058)
Constant	-37.212* (10.642)	1.193* (0.05)	0.719 (1.113)
Observations	388 ^a	388 ^a	386 ^a
R-squared	0.877	0.253	0.367

Note: Standard errors in parentheses.

* significant at 1 percent

^a Countries include Argentina, Australia, Austria, Bahrain, Bangladesh, Barbados, Belgium, Bolivia, Brazil, Bulgaria, Canada, Chile, China, Colombia, Croatia, Czech Republic, Denmark, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Germany, Greece, Guatemala, Honduras, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Jordan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Mexico, Morocco, the Netherlands, New Zealand, Nicaragua, Nigeria, Norway, Pakistan, Panama, Peru, the Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, Turkey, Ukraine, United Arab Emirates, United Kingdom, United States, Uruguay, Venezuela, and Vietnam. Dates range from 2002 through 2007. P&C insurance data are available from 2003 for most countries in the sample.

APPENDIX E
EXPORTS AND AFFILIATE SALES
EFFECTS ESTIMATION

Introduction

The Commission estimated the effects of eliminating trade restrictions on U.S. cross-border exports of insurance and U.S.-owned foreign affiliate sales of insurance. In its estimations, the Commission employed two econometric “gravity” models focusing on the different modes of trade. Gravity models have long been used to analyze trade in commodities. The literature using these models to analyze services trade and investment is relatively small, albeit growing. The Commission’s models suggest there is a substantial, inverse relationship between the ITRI, developed by the Commission to quantify NTMs that limit insurance trade, and both exports and affiliate sales.

Previous Literature

The gravity model approach to analyze cross-border trade was originally developed by Isard.¹ Walsh was the first to use a gravity model to estimate cross-border trade in individual services sectors.² In his models, Walsh employed explanatory variables commonly used to analyze trade in goods, such as distance, adjacency, population, and GDP. Stern concentrated similar research on an individual country, South Africa.³ He used the ratio of South Africa’s net exports to world net exports as the dependent variable, regressing this on less traditional variables such as domestic patents registered per adult and expenditure on research and development. The Commission extended this modeling to U.S. trade in insurance.

Brainard was one of the first to investigate bilateral trade with respect to affiliate sales.⁴ She determined that there is a robust relationship between traditional gravity model variables and affiliate sales. Bergstrand and Egger analyzed foreign direct investment and foreign affiliate sales between multiple countries using gravity models.⁵ The Commission extended this research to examine U.S.-owned affiliate sales of insurance.

Description of Data and Model

The Commission’s models use panel data, with the export model including data on U.S. bilateral exports to 31 countries from 2001 through 2005, and the affiliate sales model using data for 34 countries from 1999 to 2005. Export and affiliate data come from the Bureau of Economic Analysis. Due to data limitations, the Commission’s models are not able to isolate P&C insurance. The export data include all types of primary insurance (including life insurance), although P&C is believed to account for the majority of cross-border trade in primary insurance.⁶ The affiliate data reflect sales of both insurance and other nonbank financial services. In addition to the ITRI, both models include as independent variables the importer’s GDP, unemployment, English language, and relative distance. The importer’s GDP is measured in constant 2000 U.S. dollars, as reported in

¹ Isard, “Location Theory and Trade Theory,” May 1954.

² Walsh, “Trade in Services,” October 2006.

³ Stern, “Predicting South African Trade in Services,” 2002.

⁴ Brainard, “An Empirical Assessment of the Proximity-Concentration Trade-off,” September 1997.

⁵ Bergstrand and Egger, “A Knowledge-and-physical-capital Model,” 2007.

⁶ Harold Skipper and Robert Klein (professors, Georgia State University), interview by Commission staff, Atlanta, GA, November 10, 2008.

the World Bank's World Development Indicators (WDI). The WDI is also the source of the other macroeconomic variable, importer's unemployment rate. A dummy variable is included to capture ease of communication. This variable equals one if English is an official language, or if a minimum of 20 percent of the country speaks English.⁷ The model also includes a measurement of distance from the trading partner's capital to Washington, DC, calculated using the greatest circle formula developed by the Centre D'Etudes Prospectives et D'Informations.

The second model, focusing on affiliate transactions, includes two additional explanatory variables: foreign direct investment and so-called tertiary labor. Tertiary labor is the percentage of the labor force with at least a bachelor's degree, and is reported in the WDI. Foreign direct investment is measured as a proportion of the country's GDP and is also sourced from the WDI.

The data are generally well distributed, with good variation (tables E.1 and E.2). The ITRI is right skewed, because most countries in the model are not highly restricted. The number of observations is restricted slightly in the first model, because of the paucity of information on the importer's unemployment rate, and significantly in the second model because of the paucity of information on the percentage of tertiary labor. There is no significant correlation between the independent variables in either model (tables E.3 and E.4).

TABLE E.1 Exports—data summary

Variable	Observations	Mean	Standard Deviation	Minimum	Maximum
Exports	154	37.81	91.17	0.00	606
ITRI	155	0.43	0.28	0.00	0.93
Importer's GDP	155	6.39E11	9.13E11	5.46E10	4.98E12
Distance	155	373.83	336.83	9.56	1188.00
Importer's unemployment	144	7.52	5.21	1.3	31.2
English speaking	155	0.29	0.46	0.00	1.00
Year	155	2003	1.42	2001	2005

Source: Compiled by the Commission.

TABLE E.2 Affiliate sales—data summary

Variable	Observations	Mean	Standard Deviation	Minimum	Maximum
Affiliate sales	303	3.81E3	1.06E4	0	7.58E4
ITRI	315	0.35	0.27	0.00	0.91
Importer's GDP	319	4.14E11	7.67E11	22.44E12	4.98E12
Distance	322	8.91	0.46	8.02	9.70
Importer's unemployment	308	8.11	4.88	1.3	31.2
English speaking	322	0.28	0.45	0.00	1.00
Tertiary labor	214	25.08	9.11	7.20	51.50
FDI	319	8.85	40.65	-15.13	522.22
Year	322	2002	2.00	1999	2005

Source: Compiled by the Commission.

⁷ The 20 percent threshold is intended to recognize that English need not be the official or predominant language of a country to significantly affect commerce in that country. Other studies could reasonably establish different thresholds.

TABLE E.3 Exports—correlation matrix

	ITRI	Ln(Importer's GDP)	Ln(Distance)	Ln(Importer's unemployment)	English speaking	Year
ITRI	1.00					
Ln(Importer's GDP)	-0.23	1.00				
Ln(Distance)	0.21	-0.31	1.00			
Ln(Importer's unemployment)	-0.09	-0.05	-0.07	1.00		
English speaking	-0.17	-0.23	0.15	0.14	1.00	
Year	-0.03	0.05	0.05	0.02	0.01	1.00

Source: Compiled by the Commission.

TABLE E.4 Affiliate sales—correlation matrix

	ITRI	Ln(Importer's GDP)	Ln(Distance)	Ln(Importer's unemployment)	English speaking	Tertiary labor	FDI	Year
ITRI	1.00							
Ln(Importer's GDP)	0.18	1.00						
Ln(Distance)	0.07	0.13	1.00					
Ln(Importer's unemployment)	-0.16	-0.14	0.03	1.00				
English speaking	0.06	0.01	0.51	-0.19	-0.06	1.00		
Tertiary Labor	-0.06	0.11	0.23	-0.13	0.00	0.41	1.00	
FDI	-0.04	-0.20	-0.04	-0.16	1.00			
Year	0.07	0.00	0.08	0.00	-0.02	0.09	0.14	1.00

Source: Compiled by the Commission.

A log-log specification is used for all continuous variables except the ITRI. The year variable is a categorical representation of each year to control for an upward linear trend of insurance exports and affiliate sales over time. Neither the year nor the English dummy variable is logged. The models are as follows:

$$\ln(exports) = \alpha_0 + \beta_1 (ITRI) + \beta_2 \ln(GDP) + \beta_3 \ln(unemployment) + \beta_4 \ln(distance) + \beta_5 (English) + \beta_6 (year) + \varepsilon$$

$$\ln(sales) = \alpha_0 + \beta_1 (ITRI) + \beta_2 \ln(GDP) + \beta_3 \ln(unemployment) + \beta_4 \ln(distance) + \beta_5 (English) + \beta_6 (FDI) + \beta_7 (tertiary) + \beta_8 (year) + \varepsilon$$

The foreign direct investment and the tertiary labor variables are in the level form because the data are reported in percentages. This constructs a constant elasticity model, where the percentage increase of an explanatory variable has a direct or inverse effect on the percent change of the dependent variable.

The ITRI variable is expected to have a negative sign because the more restrictive a country is, the more difficult it is for U.S. firms to export, enter, and operate. GDP is expected to have a positive sign because the larger the economy, the more incentive there is for U.S. companies to operate in the market. An increase in GDP also indicates a greater need for P&C insurance by the foreign country. The unemployment rate is expected to have a negative sign because it is an indication of the overall health of the trading partner's economy. The distance from capital to capital is expected to have a negative sign because it is easier to trade with a country that is proximate. Although insurance is not physically transported like goods, there is travel involved with setting up and overseeing a new company. This variable may also capture cultural similarities and general familiarity with the foreign country. Foreign direct investment is expected to be positive because it captures both how open a country is to allowing foreign investment, and how desirable it is to invest in the country. The tertiary labor ratio is expected to have a positive sign because it is an indicator of a country's level of development. The year variable is expected to have a positive sign because insurance trade has been increasing at a steady rate over the past decade.

Using results from both models, the total effect of removing the trade barriers of all included countries was estimated by taking the actual value for 2005 and adding what the model predicted the increase would be if the country's ITRI equalled zero. The total growth is the summation of each country's predicted liberalized value less the fitted values.

$$\Sigma Lib_Exports_i = \Sigma e^{FittedExports_{2005}} (1 + e^{ITRI_i + \beta exports})$$

$$\Sigma Lib_Sales_i = \Sigma e^{FittedSales_{2005}} (1 + e^{ITRI_i + \beta exports})$$

Results

In the U.S. exports model, the variables ITRI, GDP, unemployment, distance, English language, and year all have the expected signs and are significant at the 1 percent level (table E.5). The adjusted R-squared is 0.65. The ITRI coefficient indicates that a 10 percentage point decrease in restrictiveness of an importing country would cause a 9.9 percent increase in U.S. insurance exports.

The ITRI has a larger effect on the U.S.-owned affiliate sales model. The variables ITRI, GDP, unemployment, distance, English language, foreign direct investment, and year all have the expected signs and are significant at the 1 percent level (table E.5). The tertiary labor ratio is not significant, but is still controlling for the overall development of each country. The adjusted R-squared is 0.72. The ITRI coefficient is valued at -1.45, implying that a 10 percentage point decrease in restrictiveness of a foreign country yields a 14.5 percent increase in affiliate sales to that country.

On the whole, the ITRI has a notable effect on both U.S. affiliate sales and U.S. exports of insurance (table E.6). If all the countries included in this analysis liberalized, the Commission estimates there could be a sizable increase in U.S. insurance sales abroad. U.S. exports to sample countries could grow from \$1.82 to \$2.69 billion, a 48 percent increase. Similarly, U.S.-owned affiliate sales in the modeled countries could grow from \$140.20 to \$179.27 billion, a 28 percent increase. Most OECD countries have the least restrictive scores, and consequently would likely witness relatively small growth in imports. Countries with the most restrictive barriers would likely see the most substantial increase in insurance trade with the United States.

TABLE E.5 Gravity model results

Variable	Ln (Exports)	Ln (affiliate sales)
Intercept	-737.6542*** (-6.66)	-232.4866*** (-2.91)
Insurance Trade Restrictiveness score	-0.9908*** (-3.41)	-1.4463*** (-3.97)
Ln(Importer's GDP)	0.6702*** (-8.76)	1.2232*** (-19.38)
Ln(Distance)	-0.6810*** (-4.95)	-0.8554*** (-3.49)
Ln(Importer's unemployment)	-0.5215*** (-3.9)	-0.6904*** (-4.19)
English speaking	1.2397*** (-6.76)	1.4008*** (-6.51)
Tertiary labor	---	-0.0061 (-0.64)
FDI	---	0.0076*** (4.28)
Year	0.3642*** (6.66)	0.1079*** (2.7)
R-squared	0.6621	0.7358
Adjusted R-squared	0.6471	0.7239
Number of observations	141	186

Source: Estimated by the Commission.

Note: Estimates have been corrected for heteroskedasticity. T-statistics are provided in parentheses below the coefficient estimates.

*** Significant at the 1 percent level

TABLE E.6 Estimated effects of liberalization, 2005

Dollar effects	Models	
	Insurance exports (billion \$)	Affiliate sales (billion \$)
Current	1.82	140.20
Liberalized	2.69	179.27
Absolute increase	.87	39.07
Percent increase	48%	28%

Source: Estimated by the Commission.

APPENDIX F
PROFIT EFFECTS ESTIMATION

Introduction

This appendix supplements the discussion in chapter 4 on calculating the profit effects of trade restrictions in P&C insurance markets, and provides information on the previous literature, conceptual framework, data, variables, and econometric specification.

The Commission estimated the effects of trade restrictions on adjusted pretax profit earned per dollar of net premiums written (or adjusted profit margins) for P&C insurance. Profit-per-dollar premium, rather than a price-cost margin, was chosen for several reasons. Premiums vary by customer and are based on a variety of risk factors, while the ultimate cost of coverage is not known at the time a policy is written, and may not be known for years after the fact. In addition, the integral role that investment plays in the insurance industry warrants its inclusion in the model, rather than a variable that reflects underwriting activities alone. The use of a variable that includes investment returns is also supported by industry experts contacted by Commission staff. The model used by the Commission estimates profit effects in two stages.¹ In the first stage, data on more than 2,700 firms are used to calculate country-level average profit margins adjusted for firm-level factors, including underwriting expenses (loss ratio and expense ratio) and investment returns. In the second stage, data from over 60 countries are used to calculate the effects on these adjusted profit margins of institutional, market, and macroeconomic variables, including an index (the ITRI) reflecting barriers to trade.² Profit effects are estimated as the amount by which P&C insurers' adjusted profit margins are inflated due to trade restrictions.

Previous Literature

The two-stage econometric model employed to analyze the effect of NTMs on financial service industries, in particular the banking industry, was developed by Saunders and Schumacher.³ Adding a trade policy variable to the second stage to calculate the effects of NTMs was pioneered by Kalirajan, et al.⁴ This method was first applied to P&C insurance by the OECD, which developed aggregate and modal tax equivalents of NTMs.⁵ Analysis performed by the Commission, however, differs in important respects. The OECD's analysis was limited to 26 transition or developing economies, whereas the Commission's sample comprises over 60 countries at different stages of development.

¹ See footnote 3 for a discussion of the two-stage econometric model.

² From this point forward, adjusted profit margins refer to the dependent variable used in the second stage.

³ It is possible to utilize a single-stage econometric approach in calculating profit effects. Estimation using a unified single-stage approach produced results qualitatively similar to those presented here. However, the use of firm-level data may skew results in a single-stage estimation, assigning greater weight to countries with many reporting companies. Additionally, it is possible that the results of a one-stage model may be subject to downward bias in standard errors, resulting in erroneous results. For example, see Saunders and Schumacher, "The Determinants of Bank Interest Rate Margins," 2000; and Moulton, "Random Group Effects," 1986.

⁴ Kalirajan, et al., "The Price Impact of Restrictions," 2000.

⁵ Tariff equivalents and tax equivalents are estimates of the price effects of NTMs, with the former measuring rents collected by incumbents and the latter measuring rents collected by exporters. Profit effects are similar to tariff equivalents in that they measure excess payments collected by incumbents, but they are different in that they measure the excess by profit margins rather than price-cost margins. Dihel and Shepherd, "Modal Estimates of Services Barriers," October 25, 2005; Dihel and Shepherd, "Modal Estimates of Services Barriers: Annex," October 27, 2005.

The aggregate and modal trade restrictiveness indices (TRIs) compiled by the OECD are based on commitments recorded in the GATS and restrictions found in the OECD Product Market Regulations Database.⁶ By contrast, the Commission's ITRI was developed from measures currently in place, using a framework based on a model schedule developed by the insurance industry. Finally, the econometric work performed by the Commission and the OECD used largely different independent variables in each stage; the Commission's ITRI variable was found to be statistically significant while the OECD's was not.⁷ Similarities between the OECD and Commission approaches include similar dependent variables and similar fit in the first- and second-stage equations.

Conceptual Framework

Restrictions on the sales of insurance by foreign firms effectively shift the foreign supply curve to the left in the domestic insurance market. Domestic supply remains unchanged because restrictions are discriminatory toward foreign suppliers. The upward shift in the foreign supply curve effectively raises the price of insurance premiums. Higher premiums and the larger investment they fund result in a wedge between the observed adjusted profit margin and the adjusted profit margin which would occur in the absence of trade restrictions under *ceteris paribus* conditions. In the context of this report, this wedge is called a profit effect.⁸ The analysis below utilizes an econometric model to estimate the size of this profit effect.

Description of Model and Data

Modeled after previous empirical work on NTMs, the first stage utilizes a log-log specification to determine the effect of four firm-level variables, as well as country dummy variables, on the profit margin, calculated as profit before taxes divided by net premiums written (see equation 2 below). Summing the constant and the coefficient of the country dummy variable yields the average profit margin for insurance carriers in that country, adjusted for the effects of firm-level attributes. Although much work of this nature calculates price effects on a price-cost margin, profit earned per dollar of premium written is a more suitable proxy for the insurance industry. As noted, calculating the price-cost margin for the insurance industry is not feasible because of the customization of individual policies, the incalculable cost of policies sold, and the paucity of information on premiums and market shares of insurance products per firm.⁹ Additionally, the operational structure of the industry suggests that a profit margin is preferable to other performance measures, such as the underwriting ratio, due to the dual core activities of policy underwriting and investment.¹⁰ The underwriting ratio captures commissions to agents and brokers, taxes, employee salaries and benefits, and other operating costs, but does not capture investment costs and returns. A substantial portion of an insurance firm's income is typically composed of returns on the investment of

⁶ The OECD compiled a trade restrictiveness index reflecting the increasing restrictiveness of regulation, weighted modally and normalized to range along a scale from zero to one. Dihel and Shepard, "Modal Estimates of Services Barriers," October 25, 2005.

⁷ Dihel and Shepard, "Modal Estimates of Services Barriers," October 25, 2005; Dihel and Shepard, "Modal Estimates of Services Barriers: Annex," October 27, 2005.

⁸ This discussion is based on Dee, "Trade in Services," November 5-6, 2001.

⁹ Bikker and van Leuvensteijn, "An Exploration into Competition and Efficiency," July 2005, 20.

¹⁰ Calandro and Lane, "The Insurance Performance Measure," 2002, 9; industry expert, e-mail message to Commission staff, December 9, 2008.

premiums during the interim between writing the policy and the payment of claims.¹¹ Losses frequently occur in the underwriting business and are typically offset by investment returns.¹² From 1999 through 2005, for example, P&C insurers in the United States recorded underwriting profits in only one year, 2004.

The second-stage regression (equation 3 below) uses a country-specific adjusted profit margin as the dependent variable, and country-level market, macroeconomic, and institutional data, including the ITRI, as independent variables.¹³ The ITRI is based on extensive primary and secondary research conducted by Commission staff on 11 specific NTMs identified by the P&C insurance industry and captures actual regulations and policies in practice, rather than trade commitments or legislation.¹⁴ ITRI values are calculated based on a scoring method previously used by Hoekman for evaluating GATS commitments.¹⁵ Hoekman classified trade policies as either completely open, completely closed, or other (for any degree in between). Policies are assigned a score of 0 if they are completely open (or permitted), and assigned a score of 1 if they are completely closed or prohibited. In many cases, policies are neither completely open nor prohibited, with these cases classified as “other” and assigned a score of 0.5. Finer scoring distinctions were not considered feasible, largely due to the notable absence of standardized language used to describe NTMs. By contrast, the largely standardized language used in GATS commitments enables detailed country-by-country comparisons, a factor behind their frequent use in quantitative policy analysis. Scores were aggregated across the 11 elements and averaged to create an index ranging between 0 and 1.¹⁶ No attempt was made to weight elements according to their perceived level of importance, largely to avoid additional subjectivity.

The profit effect is calculated using the ITRI coefficient estimated by the second-stage regression and the country-specific ITRI values for each country, in the following equation:

$$\text{Profit Effect} = 100 * (e^{\text{ITRIcoefficient} * \text{ITRIvalue}} - 1) \quad (1)$$

The equation uses the base of the natural logarithm (e) due to the log-log specification used in the first stage equation. As noted earlier, the estimated profit effect represents the amount by which P&C insurers’ adjusted profit margins are inflated due to trade restrictions, effectively capturing the excess profit margins of insurers after correcting for the influence of firm-specific factors.

Data used in the first stage included entries for more than 2,700 P&C insurance firms in over 70 different countries (tables F.1 and F.2). Data were gathered from Orbis, a large

¹¹ Calandro and Lane, “The Insurance Performance Measure,” 8.

¹² *Ibid.*, 9.

¹³ Country-specific adjusted profit margins are estimated as the sum of the intercept term and the coefficients of the country dummy variables from the first-stage regression results. This essentially measures the profit margins controlled for firm-specific variations, or the portion of the profit margin not determined by the firm-specific variables.

¹⁴ Common criticisms of empirical work in this field based on GATS commitments are that the commitments are outdated and do not reflect actual practice in the countries.

¹⁵ Hoekman, “Tentative First Steps,” May 31, 1995, 15.

¹⁶ Two of the elements regarding market access are closely related. One pertains to the existence of equity limitations, and the other, the staged elimination of such limitations. In the absence of equity limitations, the issue of staged elimination of such limits is considered “not applicable.” The ITRI is then computed as the aggregate score averaged over the 10 applicable elements.

TABLE F.1 Summary statistics of firm-level data

	Profit margin	Net premium to surplus ratio	Investment return	Loss ratio	Expense ratio
Mean value	0.4214	1.4833	0.0444	66.6140	35.0709
Maximum	238.25	104.6642	1.9695	983.97	888.2350
Minimum	-116.026	-22.7365	-3.3835	-649.37	-451.8020
Standard deviation	6.1353	3.7004	0.1012	49.4703	45.8690
Number of observations					2,786

Source: Compiled by the Commission using Bureau van Dijk, Orbis Companies Database (accessed January 13, 2009).

Notes: Statistics are calculated for the data used to run the regression. The particular log-log specification used in calculating profit effects resulted in the omission of any negative values.

TABLE F.2 Country distribution of firm-level data

Top 10 countries		Regional information	
Country	Number of companies	Country	Number of companies
United States	1,292	North America	1,408
Germany	218	Europe	860
United Kingdom	132	South & Central America	286
France	102	Asia	220
Spain	95	Rest of World	12
Argentina	90		
Canada	59		
Mexico	57		
Brazil	48		
Switzerland	46		

Source: Compiled by the Commission from Bureau van Dijk, Orbis Companies database, (accessed January 13, 2009).

Note: Those companies that did not report the variables of interest were automatically omitted from the regression. As a result, although Australia had a significant number of observations, it is not included in the profit effect calculation because the companies did not report either the expense or the loss ratios.

database containing financial information for more than 51 million international companies.¹⁷

These data were then used in the following estimation in the first stage:

$$\ln(\text{profit margin}) = \beta_0 + \beta_1 \ln(\text{investment return}) + \beta_2 \ln(\text{net premium to surplus ratio}) + \beta_3 \ln(\text{expense ratio}) + \beta_4 \ln(\text{loss ratio}) + \beta_5 \sum_{i=1}^{66} \text{country dummy}_i \quad (2)$$

The dependent variable for the first stage is the profit margin, which, as noted above, is profit before tax per dollar of net premium written. The measure of investment return was calculated by taking a ratio of investment income (the sum of net investment income and other gains/losses) to funds invested (the sum of net technical reserves and surplus).

¹⁷ Bureau van Dijk, Orbis Companies Database (accessed January 13, 2009).

Investment return, which is expected to have a positive sign, provides an indicator of firms' investment acumen and serves to control for investment earnings. The ratio of net premiums written to surplus measures the degree to which insurance firms are exposed to risk. There is generally a maximum ratio set by regulatory agencies as a way to ensure firms' solvency.¹⁸ The variable is expected to have a negative sign since higher exposure to risk results in more claims payments and lower profits.¹⁹ The expense ratio measures a firm's operating cost and management skills, and is defined as operating expenses, such as overhead, as a percentage of premiums written.²⁰ Similar to the expense ratio, the loss ratio is an indicator of the insurer's underwriting performance, including risk assessment and pricing, measuring losses and related loss adjustment expenses as a percentage of premiums earned.²¹ Both the expense and loss ratios are expected to have negative signs, as high costs decrease profitability.

In the second stage, market, macroeconomic, and institutional variables are used to account for variance in country-specific adjusted profit margins, the dependent variable. Country-specific adjusted profit margins are estimated as the sum of the country dummy coefficient and the intercept in the first-stage regression.²² This report considers two different specifications of the second-stage equation, each of which are run twice.²³ The first regresses adjusted profit margins on the ITRI, perception of corruption index, lagged real interest rate, an index of the percentage of GDP at risk from natural disasters, the unemployment rate, and the combined market share of the top five companies. The second specification is very similar, but replaces the index of corruption with an index of property rights. The second-stage equation is:²⁴

$$\text{Adjusted Profit Margin} = \beta_0 + \beta_1 (\text{insurance trade restrictiveness index}) + \beta_2 (\text{property rights or corruption index}) + \beta_3 (\text{real interest rate from previous year}) + \beta_4 (\text{percentage of GDP at risk}) + \beta_5 (\text{unemployment rate}) + \beta_6 (\text{market share of top 5 companies}) \quad (3)$$

The ITRI variable, described above, is expected to have a positive sign, because the existence of policy restrictions is theorized to allow incumbent firms to extract profits higher than they would otherwise command in an open trading market. The first model specification includes an index measuring the perception of corruption in a country, which ranges in value from 0 to 10. Low values indicate a highly corrupt environment, while a value of 10 indicates the absence of corruption, which is defined as the misuse of public

¹⁸ Although regulatory agencies set a maximum ratio permitted for volume of premiums written, relative to surplus, firms generally self-regulate and remain below this level.

¹⁹ It is possible to witness a positive relationship between profit ratio and risk exposure, if investors require higher returns to compensate for greater degrees of exposure.

²⁰ Standard & Poor's, Industry Surveys, Insurance: Property-Casualty, January 25, 2007, 29.

²¹ Ibid.

²² The sum of the country dummy coefficient and the intercept in the first-stage regression captures the country-specific variation in the log of the profit margin not explained by the firm-level variables. OLS moves errors to the constant in order to satisfy the assumption that errors have a zero population mean.

²³ The U.S. P&C market is subject to regulation that varies by state. To account for this, the Commission postulated two ITRI scores for the United States: one score of 0, assuming a completely open market, and one score of 0.5, assuming a market that is neither completely open nor completely closed. Regressions were performed with both these scores, separately, to gauge their separate effects. Regression results were virtually identical, demonstrating the robustness of the Commission's model. In both instances, the ITRI was significant at the 10 percent level.

²⁴ Resulting regression estimates are corrected for heteroskedasticity. Alternative estimations using other measures of risk, demand, and other macroeconomic factors, yielded results qualitatively similar to those reported.

power for private benefit, such as bribery of public officials or kickbacks in public procurement.²⁵ The corruption index is expected to have a positive sign, because high levels of public corruption increase the cost of doing business and decrease profitability. The second specification substitutes a property rights index for the corruption index. The property rights index is an assessment of the degree to which the personal property of individuals is protected by legal enforcement of the state, which ranges in value between 0 and 100.²⁶ Higher index values indicate greater property rights. The property rights index is expected to have a positive sign, because greater property rights are integral to the ability to provide insurance. The real interest rate is a lag variable. It is based on quarterly data from 2004, and is calculated as the nominal interest rate corrected for inflation.²⁷ It provides an overview of the investment environment, and is lagged on the theory that previous performance will influence the investment decisions made in 2005. The variable is expected to have a positive sign, as high interest rates increase profitability, and insurance firms generally place reserves in short-term investments. The index of percentage of GDP at risk measures a country's economic risk exposure from two or more natural disasters. The variable is expected to have a negative sign, as a higher percentage indicates a higher exposure to risk.²⁸ The unemployment rate is another demand factor expected to have a negative relationship with the adjusted profit margin. As unemployment rises, demand for insurance decreases, resulting in a lower adjusted profit margin. Finally, the combined market share of the top five firms indicates the degree of concentration in the market. The expected relationship with the adjusted profit margin is ambiguous. It may be positive if firms are achieving economies of scale, or it may be negative if the market has few firms exercising market power.

Results

In the first stage, the net premiums to surplus ratio, loss and expense ratios, and investment return variable are of the expected sign and statistically significant at the 1 percent level (table F.3). The R-squared in the first stage is 0.51, indicating that firm-level variables explain approximately 51 percent of variation in firms' profit margins.

²⁵ Transparency International, "Corruptions Perception Index, 2006: FAQ," undated (accessed November 5, 2008).

²⁶ Holmes, et al., *2008 Index of Economic Freedom*, 2008, 41.

²⁷ Data were collected for money market rates where possible, and supplemented with the T-bill and government bond rates. IMF, International Financial Statistics Database.

²⁸ It may also be argued that the variable measuring percentage of GDP at risk should have a positive relationship with the corrected profit ratio. It is possible increased exposure to risk may lead investors to demand higher average returns, resulting in higher profits. Data collected from World Bank, "Natural Disaster Hotspots," 2005.

TABLE F.3 Stage 1 results, dependent variable: ln (profit margin)

Variable	Coefficient
Intercept	3.156 (7.63)
Ln(Investment return)	0.412*** (12.12)
Ln(Net premium to surplus ratio)	-0.611*** (-21.46)
Ln(Expense ratio)	-0.337*** (-8.01)
Ln(Loss ratio)	-0.673*** (-9.35)
R-squared	0.5081
Adjusted R-squared	0.4923
Number of Observations	2257

Source: Estimated by the Commission.

***Significant at 1 percent level

Notes: Estimates are corrected for heteroskedasticity. Coefficients for country dummies are not reported. T-statistics are provided in the parentheses below coefficient estimates.

Results for the two specifications described in the previous section are presented for the second stage (table F.4).²⁹ The R-squared values are similar, irrespective of the specification used, ranging around 0.25. In the second stage, the ITRI exhibits the largest coefficient value, is of the expected sign (positive), and is significant at the 10 percent level, indicating that measures restricting trade contribute significantly to higher adjusted profit margins. The corruption perception index (specification 1) and property rights index (specification 2) are also both positive (the expected sign), and generally significant at the 1 percent level.³⁰ The index of percentage of GDP at risk from natural disasters is significant at the 5 percent level and of the expected negative sign, consistent with the theory that higher costs result from increased exposure to risk. The remaining variables, the real interest rate, unemployment rate, and market share of the top 5 firms, were not statistically significant in any of the specifications.

²⁹ Sensitivity analysis was performed to verify the model's robustness. Specifications included one that assigned dummy variables to the components of the ITRI based on mode of provision. This specification found significant results from the commercial establishment elements, which would be expected to have the largest impact on protected profits.

³⁰ In specification 2, using the least restrictive U.S. ITRI value, the coefficient for the property rights index was marginally less significant, at the 5 percent level.

TABLE F.4 Stage 2 results, dependent variable: Adjusted profit margin

Variable	Specification 1		Specification 2	
	U.S. (ITRI = 0)	U.S. (ITRI = 0.5)	U.S. (ITRI = 0)	U.S. (ITRI = 0.5)
Intercept	2.6341 (7.72)	2.606 (7.612)	2.6008 (7.297)	2.5879 (7.309)
Insurance Trade Restrictiveness Index	0.402* (1.846)	0.4359* (1.931)	0.3549* (1.687)	0.3749* (1.728)
Corruption perception index	0.072*** (2.601)	0.0718*** (2.667)	---	---
Property rights index	---	---	0.0071** (2.519)	0.007*** (2.569)
Real interest rate (2004)	0.0014 (0.118)	0.002 (0.166)	0.001 (0.078)	0.0015 (0.119)
Percentage of GDP at risk index	-0.1081** (-2.074)	-0.1124** (-2.162)	-0.1141** (-2.31)	-0.1178** (-2.367)
Unemployment rate (2005)	0.0171 (1.261)	0.0174 (1.305)	0.0167 (1.146)	0.0169 (1.165)
Market share of top 5 insurance firms	-0.001 (-0.472)	-0.0008 (0.319)	-0.0007 (-0.322)	0.0005 (-0.235)
R-squared	0.2553	0.2597	0.2559	0.2579
Adjusted R-squared	0.1659	0.1709	0.1666	0.1689
Number of observations	57	57	57	57

Source: Estimated by the Commission.

Notes: Estimates have been corrected for heteroskedasticity. T-statistics are provided in parentheses below the coefficient estimates. The U.S. P&C market is subject to regulation that varies by state. To account for this, the Commission postulated two ITRI scores for the United States: one score of 0, assuming a completely open market, and one score of 0.5, assuming a market that is neither completely open nor completely closed.

- * Significant at the 10 percent level
- ** Significant at the 5 percent level
- *** Significant at the 1 percent level

From these results, profit effects were estimated using specification 1 (table F.5). As previously mentioned, estimated profit effects are defined as the amount by which P&C insurers' adjusted profit margins are inflated due to trade restrictions (equation 1 above). Countries are grouped based on the estimated magnitude of their respective profit effect. Overall, 20 countries have profit effects greater than 20 percent, due to currently restrictive trade policies.³¹ Twenty-seven countries have profit effects of 10 percent or lower. Developed countries, such as the OECD economies, generally have smaller profit effects due to lower levels of trade restrictions. By contrast, developing economies such as China and India exhibit higher estimated profit effects. Countries with the highest profit effects have the most to gain from liberalization as consumers may benefit from lower premiums.

TABLE F.5 Estimated profit effects in the P&C insurance industry

0 to 10 percent	11 to 20 percent	21 to 35 percent	Greater than 35 percent
Austria	Japan	Canada	Argentina
Belgium	Jordan	Chile	Barbados
Bolivia	Latvia	Colombia	Brazil
Bulgaria	Lithuania	Croatia	China
Czech Republic	Luxembourg	Guatemala	India
Denmark	New Zealand	Ireland	Italy
Ecuador	Panama	Netherlands	Korea
Egypt	Portugal	Norway	Mexico
Finland	Romania	Peru	Morocco
France	Slovenia	Philippines	Pakistan
Germany	Spain	Singapore	Poland
Hong Kong	Switzerland	Sri Lanka	Saudi Arabia
Hungary	United Kingdom	Sweden	South Africa
Iceland		Tunisia	
			Bangladesh
			Indonesia
			Malaysia
			Russia
			Thailand
			Vietnam
			Venezuela

Source: Compiled by Commission staff.

Notes: The estimated profit effects are the amount by which P&C insurers' adjusted profit margins are inflated due to trade restrictions. Adjusted profit margins are "adjusted" for the effects on total profit margins of firm-level variables, such as loss ratios, expense ratios, risk exposure, and investment acumen. It is necessary to adjust the total profit margin for the effects of firm-level variables in the first stage so that the effects of country-level variables, including the ITRI, can be isolated in the second stage.

³¹ The United States is included in these 20 countries, based on the states with the most restrictive policies.



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
The U.S. Insurance Sector: International Competitiveness and Jobs

May 17, 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.

NAMIC agrees with the need for American companies to be able to compete in the international insurance market and urges the subcommittee, Congress, and the new Federal Insurance Office (FIO) to work to assist companies seeking to do business abroad in emerging markets. For example, we believe increased coordination and cooperation among international regulatory authorities is desirable and would allow insurers more predictability when entering new markets. Present cooperation between the European Union and U.S. provides a sound basis for further collaborative efforts.

That said, too much of a focus on regulatory congruence and securing international trade agreements that benefit U.S. insurers seeking to do business abroad could lead to negative consequences for those only serving the domestic market. It is our position that cooperation and coordination on the regulatory front is a positive thing, but should not come at the cost of abdication of regulatory authority to foreign jurisdictions or quasi-governmental bodies. Any and all efforts toward promoting U.S. competitiveness abroad should take care not to impose new burdens on the U.S. market.

Currently, the movement of capital that is intended for risk or insurance generally flows freely into and out of the U.S. For example, we do not believe that the current system imposes an inappropriate or undue impediment to participation in U.S. markets by non-U.S. insurers. International coordination of reporting or presentation standards to permit review and evaluation help to foster greater regulatory transparency and encourage competition both at home and abroad.

Regulation at the International Level

Efforts to regulate large, multi-national insurers has been an evolving process, one in which the U.S. has been actively engaged. U.S. insurance regulators – through the National Association of Insurance Commissioners (NAIC) and now the FIO – participate in the International Association of Insurance Supervisors (IAIS). The IAIS develops international standards for insurance supervision, provides training to its members, and fosters cooperation between insurance regulators, as well as forging dialogue between

insurance regulators and regulators in other financial and international sectors. Regulators and staff participate in the work of the IAIS on a variety of issues including international solvency supervision, accounting standards, and reinsurance regulation, among others. The IAIS has developed a set of Insurance Core Principles ("ICPs") which lay out international requirements and best practices for regulators.

The IAIS has supported the use of supervisory colleges as a means for international regulators to convene and discuss a particular insurance group. We support the use of supervisory colleges and believe their use is largely consistent with the NAIC's lead state concept, in which the states have held periodic regulator-to-regulator conference calls to discuss issues related to a particular insurance group. Supervisory colleges provide the opportunity for enhanced information sharing and regulatory dialogue affording regulators superior knowledge of the group and regulatory and environmental pressures. Such forums are particularly beneficial when they are developed around management's discussion of the insurance group with the most impacted supervisors. It is NAMIC's position that the international coordination of insurance regulation should be centered on understanding the risks of the insurance group from the perspective of how the insurance group identifies and manages its risk. We believe this type of communication is the foundation on which international coordination of insurance regulation should be developed.

NAMIC remains concerned, however. The IAIS has become far too prescriptive when it comes to ICP requirements and we are concerned that such principles, if forced onto the U.S. system, could weaken the U.S. regulatory system as opposed to strengthen it. The fact is, the realities of the U.S. insurance market are not always the same as those in other countries or regions. For instance, most European countries do not regulate the price of insurance products whereas price regulation is common in the U.S. Also, our tort environment is very different from most other countries; these realities must be considered and reconciled before the U.S. regulators adopt any policies designed to streamline international regulation. Additionally, we have concerns about the transparency and accountability of the IAIS process, especially in light of the potential impact of IAIS proposals on the substance of U.S. regulatory system. While improvements have been made, much work remains for the IAIS deliberations to be considered transparent.

In that vein, the E.U.'s Solvency II initiative raises concerns. Although not even implemented fully in E.U. countries, there is already talk of "equivalency" considerations for foreign insurance markets; in other words, a grading system of a country's regulatory system. The U.S. has historically taken an approach to solvency of protecting the policyholder, while the European model tries to ensure there will never be an insolvency. The two fundamental differences in philosophy carry through to standards, making it difficult to achieve convergence or determine equivalency. This creates a serious concern – if the U.S. were not deemed equivalent, U.S. insurers seeking to do business in the E.U. would be subjected to an onerous set of additional requirements. NAMIC believes that the current U.S. system should be deemed equivalent as is, and

changes should not be forced on domestic regulators simply due to equivalence considerations.

We appreciate that both U.S. regulators at the NAIC and those at the FIO recognize the uniqueness of our system and have made statements to the effect that they will only accept the international best practices where they make sense for the U.S. market.

Trade Agreements

Trade agreements can be important for securing U.S. insurers' access to foreign markets. However, in the quest to successfully negotiate these agreements, care must be taken not to subject U.S. insurers to complicated new prudential standards that do not make sense in a domestic context. To that end, the FIO has been empowered to coordinate federal efforts on insurance which includes assisting the Secretary of the Treasury in negotiating international insurance agreements on prudential measures. We believe that having someone at the table that understands the insurance market will go a long way to ensuring that we avoid unintended consequences for the U.S. market. Regardless, authority to enter into agreements and bind U.S. insurers and insurance regulators should not depend solely on the discretion of the Secretary of the Treasury; agreements affecting insurance must be negotiated in full coordination with state regulators and Congress must not abandon its oversight function and should exercise full consultative authority.

Conclusion

NAMIC supports the participation of the FIO and state regulators in greater dialogue and coordination with international insurance regulators as this will lead to greater access to foreign markets for U.S. insurers. NAMIC also believes the current U.S. state-based insurance regulatory system is robust and well-positioned to meet the needs of the nation's insurance marketplace. While working closely to reduce redundancies and achieve greater transparency internationally, we caution policymakers to be wary of overlapping or dual regulatory processes that would significantly increase the cost of doing business for insurers in the U.S.

Testimony**Property Casualty Insurers Association of America (PCI)****U.S. Insurance Sector: International Competitiveness and Jobs
Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises
Committee on Financial Services
United States House of Representatives
Thursday, May 17, 2012**

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to submit testimony to the Subcommittee concerning international competitiveness in the insurance sector. PCI is the leading property-casualty trade association. PCI is composed of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write over \$180 billion in annual premium, 38.3 percent of the nation's property casualty insurance. Member companies write 44.3 percent of the U.S. automobile insurance market, 31.6 percent of the homeowners market, 36.3 percent of the commercial property and liability market, and 42.6 percent of the private workers compensation market.

For most of the history of the U.S. insurance industry, regulatory issues have been focused almost solely on the state level where insurance is regulated, with only limited focus in Washington, D.C. on discrete issues such as flood and terrorism insurance. In recent years, however, insurance standards affecting almost every aspect of regulation are being established by financial supervisors outside of the U.S. in various international fora.

This internationalization of insurance regulation has significantly escalated since the onset of the 2008 financial crisis. In 2009, the G20 finance ministers and bank regulators committed to establishing "internationally agreed high standards that a global system requires" and to create a new Financial Stability Board (FSB) of primarily finance ministers and bank regulators to "reshape our regulatory systems". The U.S. Department of Treasury the same year advocated the need to "coordinate international financial policy through the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision". FSB members, including Treasury and the Federal Reserve Board, have committed their countries to implement global standards, including FSB standards on insurance and the insurance core principles (ICPs) developed by the International Association of Insurers Supervisors (IAIS).

While insurance has not been a primary focus of the G-20 or FSB, demands for additional insurance regulation are frequently included in the barrage of FSB international reform directives because insurance is a part of the financial sector, and especially because insurers often exist within financial groups that engage in a range of financial services. Neither Congress nor the states have authorized any of these international standard setting efforts, nor does the FSB include any insurance-specific members other than the IAIS. Yet the breadth of demands to impose often bank-centric or European-centric standards has been rapidly expanding, frequently with no showing of existing U.S. regulatory shortcomings that would justify such new standards to

protect consumers in the U.S. marketplace. Insurers are not banks, and property-casualty insurance in particular is influenced by local rules and structured in a uniquely different manner from banking and investment conglomerates whose activities might be more conducive to global regulation or standards.

For more than a hundred years, the states have successfully regulated the business of insurance. State solvency regulation has been particularly successful in the last two decades, achieving a high level of relative uniformity with few failures – particularly during the recent financial crisis. While catastrophic failures occurred in other parts of the financial services sector in the U.S. and worldwide, there were no major failures in the U.S. insurance sector, with traditional home, auto, and business insurance activities particularly strong and solvent. While some of the financial firms that faced challenges in 2008 did have insurance subsidiaries, those subsidiaries remained well-capitalized and strong while other more risky non-insurance activities occurring in other subsidiaries created the difficulties. Thus, the state insurance regulatory system performed well and insurance activities were not a cause of the financial crisis.

PCI and the states have previously recognized that there are limited areas where state insurance law can be improved in discussions with international standard setters. In particular, PCI is actively supporting the ongoing efforts by the states to strengthen group supervision and holding company oversight through adoption of updates to the National Association of Insurance Commissioners' (NAIC) Model Holding Company Act and development of an Own Risk and Solvency Assessment (ORSA) model law. PCI is also working with the NAIC on its Solvency Modernization Initiative (SMI). However, U.S. consumers and the marketplace would not benefit from a complete overhaul just for the sake of implementing international standards that are not designed for the U.S. marketplace. For example, both the Federal Insurance Office (FIO) and the NAIC have recently suggested that U.S. consumers would not benefit from having the United States replace the well-tested state regulatory system with the Solvency II standards that are required by the European Union for equivalence, particularly since Solvency II is still an untested system that could significantly impact U.S. competitiveness. We urge the Congress to monitor these developments closely and to discourage inappropriate international pressure on the U.S. regulatory system that is not in the best interests of U.S. consumers.

The following will summarize a number of current key international insurance regulatory efforts. At this time, we believe that these issues are most appropriately addressed by the industry, state insurance regulators and their international counterparts, and there is no current need for active Federal intervention beyond general monitoring of developments and countering any inappropriate pressure on state insurance regulators from international banking-dominated entities. The one exception is that the FIO has been given statutory authority to "coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters." This is the area in which the FIO can make its most constructive contribution and PCI believes that Congress should urge the FIO to make international insurance leadership its primary focus. Indeed, the FIO has already moved into a positive international leadership role for insurance.

New Global Supervision - Background

Prompted by the 2008 financial crisis, the G20 converted the Financial Services Forum, a former think-tank organization made up primarily of banking regulators and focused on bank regulation into what is now known as the Financial Stability Board (FSB). The FSB is charged with providing an early warning of financial risks, reshaping regulatory systems, and extending regulation and oversight to all systemically important financial institutions and markets. The FSB's new membership was expanded to include numerous additional banking regulators, finance ministers, and standard-setting bodies, including the International Association of Insurance Supervisors (IAIS).

The IAIS was created in 1994 to "promote effective and globally consistent supervision of the insurance industry." It includes insurance regulators from 190 jurisdictions (including the FIO) constituting 98 percent of the world's insurance premiums. IAIS members, including U.S. state insurance regulators, are committed to IAIS standards, including the 26 IAIS Insurance Core Principles (ICPs) on issues such as corporate governance, accounting standards, holding company risk oversight, and capital standards. U.S. commitments to the ICPs flow from both federal banking (and securities) regulators representing our country globally and from state insurance regulators through their IAIS membership. Commitment does not mean the international standards are automatically adopted in the U.S. Nevertheless, federal and state regulators are vested in the development of the international standards and may often feel honor bound to adopt them domestically. Moreover, U.S. regulators know that they will be subject to international and public review and critique, including a formal critique by the International Monetary Fund (IMF) and the World Bank every five years in those organizations' Financial Sector Assessment Program (FSAP). They are also aware that the FSB is developing a "toolbox of measures to promote adherence." These considerations automatically make international standards part of the domestic agenda and they often become a default position, likely to be adopted except where regulators determine that the standards are inappropriate for our local market. PCI recognizes international concerns about group risk supervision, which the states are rapidly addressing, but opposes efforts to impose uncompetitive international standards wholesale, particularly where no gap or considered need has been specifically identified.

International Systemic Importance

The IAIS has announced that the FSB and "national authorities" will not determine until the first quarter of 2013 which, if any, large global insurers are systemically important (G-SIIs, for "global systemically important insurers"). U.S. insurers had strongly urged the IAIS and the FSB not to rush their process to meet any predetermined timelines and, in particular, to take care not to enact global standards that would deviate from U.S. systemic risk designation procedures and standards for nonbanks that have only just recently been finalized. PCI has demonstrated with extensive quantitative and qualitative analysis in both domestic and international fora that companies engaged primarily in traditional property casualty insurance are not systemically important, although a few insurance holding companies may be engaged in systemically important activities through non-insurance affiliates.

IAIS ComFrame Developments

In July 2010, the IAIS announced the development of the Common Framework for the Supervision of Internationally Active Insurance Groups (or ComFrame). ComFrame is intended to: (1) develop methods of operating group-wide supervision of Internationally Active Insurance Groups (IAIGs) in order to make group-wide supervision more effective and more reflective of actual business practices; (2) establish a comprehensive framework for supervisors to address group-wide activities and risks; and (3) foster global convergence of regulatory and supervisory measures and approaches. ComFrame has been one of the most divisive insurance standard development efforts, with many of ComFrame's proponents pushing for global standards and regulation of IAIGs, including common capital standards. ComFrame discussions have also been divided over whether group regulation should be merely coordinated through an international supervisory college (which are rapidly being formed for not-yet-designated IAIGs) or formalized with additional layers of international regulation.

U.S. insurers continue to resist attempts to impose heightened capital, reporting and other standards for IAIGs, and in general are supporting the NAIC's efforts to focus ComFrame on increased international cooperation and development of a coordinated system with some common language to help regulators assess group capital. PCI recognizes that it may be appropriate to improve regulatory coordination of supervision of international insurers. However, insurers should not be penalized merely because they are geographically diversified, particularly where they may be smaller or less complex than their domestic competitors. While international regulation of U.S. insurers doing business in multiple countries may create a level playing field relative to their most hamstrung foreign competitors, it hurts U.S. competitiveness domestically and internationally, creating a local unlevel playing field and impairing U.S. insurance jobs.

Accounting Convergence

One of the first FSB-announced priorities is global adoption of international accounting standards. The International Accounting Standards Board (IASB) and the (U.S.) Financial Accounting Standards Board (FASB) are nearing conclusion of their negotiations over their proposed international accounting standards for insurers. Of particular note are ongoing pressures from the IASB to change U.S. accounting for insurance contracts, requiring additional risk margins and discounting for insurance reserves, even for non-life reserves where it would add additional uncertainty, reducing the value of insurance information for investors and imposing additional costs for insurers. The Boards are also continuing to work through the remaining issues in other key joint convergence projects including accounting for leases and how to account for various financial instruments, both of which could have an impact on insurers' financial statements. The SEC is expected to announce its decision on whether to adopt in whole or in part International Financial Reporting Standards (IFRS) for publicly traded companies in the United States later this year. Subsequent to a determination by the SEC, the NAIC and state insurance regulators have indicated they will make a determination regarding the extent of convergence of the SEC's authorized accounting standards into state regulatory Statutory Accounting Principles (SAP). PCI members analyzing the cost of full accounting convergence have suggested that the initial implementation costs could exceed those of Sarbanes-Oxley with questionable, if any, benefits for consumers or investors.

Solvency II / U.S.-EU Equivalence

The European Union is working towards modernization of Europe's prudential insurance regulation under a new system called Solvency II. While Solvency II has not yet been finalized or implemented, the EU is requiring foreign jurisdictions to have equivalent standards to their planned system in order to avoid discriminatory treatment. Solvency II includes three pillars: (1) quantitative financial requirements such as capital; (2) governance, risk management and supervision; and (3) disclosure; with a particular focus on increasing insurance capital requirements and risk management. The Solvency II Directive provides for an assessment by the European supervisors of the "equivalence" of non-EU jurisdictions, to determine whether they provide a similar level of policyholder/beneficiary protection as the one provided under the Solvency II Directive. Insurers from countries without equivalence will face discriminatory regulatory standards.

While the U.S. will not be among the countries initially deemed equivalent, the EU's Solvency II update (expected this fall) will include a special process during which certain jurisdictions, including presumably the United States, that agree to work toward equivalence will be treated as equivalent during a five-year transitional period. FIO and the NAIC have insisted that this process focus on "mutual recognition" more than "equivalence." They point to the success of the time-tested US solvency regulatory system and question whether it should be judged against a theoretical European system designed for a significantly different market that will not even be implemented fully until 2014.

The Transatlantic Dialogue and the ongoing discussions by the FIO, NAIC, European Commission (EC) and European Insurance and Occupational Pensions Authority (EIOPA) regarding US and EU insurance regulation appear to be engendering greater understanding of each other's regulatory systems. A joint "steering committee" has been created to organize reviews of several issues of difference, including group supervision, minimum capital standards, reinsurance collateral, and confidentiality and data protection. Formal semi-annual meetings are being held, one each in the U.S. and in Europe. PCI urges Congress to monitor these developments closely and to discourage the imposition on U.S. insurers of excessive and unnecessary EU standards. The U.S. state insurance regulatory system has a strong solvency record that served the U.S. market well during the 2008 financial crisis and its aftermath, with additional improvements in group supervision already underway. The EU has a different regulatory system based on different market structures, tort laws, and corporate governance, which may not always be appropriate for the U.S. market and consumers.

Confidentiality

Confidentiality and data security are slowly increasing in significance in international financial dialogues. As insurers are being pushed to report proprietary information to various non-regulators such as the NAIC, and ultimately to non-government entities such as the IAIS, FSB, and G20, control and limits on the scope of sharing of confidential data are weakening. For example, the FSB has demanded access to information that a limited group of U.S. insurers previously provided through their state regulator solely for review by the IAIS. The FSB is not a regulator or government entity and its request exceeds the scope of the IAIS' promises when the data was

collected. While the various new international players have been developing information-sharing Memoranda of Understanding (MOUs), the protections are still being developed and the legal certainty of these MOUs is still in question. PCI encourages the Congress to monitor developments carefully to ensure that adequate confidentiality protections are in place for U.S. industry and consumers

NAIC Response

The aforementioned international developments and pressures have prompted the NAIC to undertake several initiatives in response:

Model Holding Company Act. The NAIC quickly addressed the need identified during the recent financial crisis for greater oversight of the potentially systemically risky non-insurance activities of insurance holding companies by adopting revisions to its the Model Holding Company Act (MHCA). This Act requires insurance holding companies to report to regulators at least annually on their enterprise risks, including future business plans, information on guarantees from one affiliate to another, and any material activity that could adversely affect the group. The MHCA also requires certain notices of change of control, greater regulation of certain affiliate transactions, increased authority for state insurance regulators to examine an insurers' affiliates' enterprise risk, and authorization to institute or participate in supervisory colleges of regulators of international groups. PCI actively supports state adoption and uniform implementation of the MHCA, recognizing that it successfully addresses the primary insurance regulatory gap identified during the recent financial crisis.

Own Risk and Solvency Assessment (ORSA). State insurance regulators are also trying to enhance supervision of enterprise risk management through development and adoption of a model law on Own Risk and Solvency Assessments ("ORSA"). The ORSA concept, based on Solvency II and the IAIS' enterprise risk management standards, requires insurers to conduct a periodic assessment of their risk management policies, exposure to stressed situations, and adequacy of their capital when all material risks are taken into account, and to report on this process to their regulators at the regulator's request.

The NAIC's Group Solvency Issues Working Group recently released a revised draft ORSA Model Law that was disappointing in that it omitted several key items that are necessary for insurers to comply. The latest draft fails to reference a "lead state" that would coordinate regulatory requests for ORSA-related information after domiciliary regulators have received ORSA reports from their companies, as well as containing inadequate confidentiality protections. PCI is working closely with the NAIC, state regulators, and our industry colleagues to achieve a workable ORSA Model Law that can be adopted uniformly by the states. A proper ORSA requirement could be an important complement to the MHCA in providing state insurance regulators with broad enterprise risk oversight of insurance holding companies, as well as allowing international groups to file one ORSA report worldwide.

Corporate Governance. One of the 26 IAIS's Insurance Core Principles (ICPs) sets forth global standards that countries are supposed to adopt for corporate governance. The NAIC began formal consideration in 2010 of that ICP together with a White Paper for use in U.S. insurance regulation,

asking insurers for comments as to how U.S. insurance regulators may achieve substantial compliance with the IAIS ICPs. PCI and many others strongly objected to application of the IAIS corporate governance principles in the U.S., noting that they are largely based on a European civil code system, for a different type of insurer, with less prominent tort and commercial law than is the case in the U.S. The NAIC subsequently began to conduct a comparison of all current US corporate governance requirements with the NAIC's solvency regulation core principles and the IAIS' ICPs and has since proposed a new set of annual disclosures with regards to the board's corporate governance activities and significantly increased examination guidance. Current discussions with the NAIC are now underscoring that consumers could be better served by reviewing current U.S. regulatory and legal corporate governance requirements to assess any gaps that could harm consumers, rather than trying to achieve similar outcomes to a global standard designed for other countries' systems.

Other Issues

Reinsurance Collateral. U.S. trade negotiators and state insurance regulators have been under pressure for some time from the E.U. and elsewhere to reduce current requirements that non-U.S. reinsurers must post collateral protecting their liabilities to U.S. insurers. Most domestic insurers continue to believe that maintaining collateral protections is an important tool to strengthen their ability to collect on reinsurance claims from non-U.S. reinsurers. Nevertheless, late last year, the NAIC adopted revisions to its model law and regulation on credit for reinsurance under which reductions in collateral would be permitted based on a number of factors, including the non-U.S. reinsurer's financial rating and an assessment of the quality of insurance regulation in the reinsurer's domiciliary jurisdiction. A number of states are now considering legislation to bring their laws more closely in line with the revised models.

Because the final amendments to the NAIC models included some important protections for U.S. ceding insurers, PCI pledged not to oppose state legislation and regulations that are consistent with those models. However, as these new requirements become effective in the states, we are entering a time of testing in which we will be able to observe whether the loss of full collateral will create any collection issues for U.S. ceding insurers that full collateral had previously prevented.

The Federal Insurance Office will be watching these developments and will undoubtedly be considering whether and how to use power granted to FIO, Treasury, and the USTR by the Dodd-Frank Act to negotiate international agreements on reinsurance collateral requirements, which could then preempt state law. Given that new reduced collateral requirements in the U.S. are only just beginning to take effect, we would urge FIO to take the time to allow the new rules to work and to fully assess their impact before considering any aggressive moves to preempt state law in this area. PCI looks forward to working closely with the FIO and the Congress to assist in evaluating the impact of these new rules on the U.S. market.

Access to Markets in China. Like other U.S. industries, the insurance industry is keenly interested in the growing market in China and in China's willingness to open its markets more fully to international financial services firms. PCI is a member of Engage China, a coalition of 12 U.S. financial services trade associations, which testified yesterday at a hearing in the International Monetary Policy and Trade Subcommittee. Engage China is working hard to promote more open

and transparent Chinese financial markets, and while there is much work yet to do, we do want to highlight one recent and very positive development. In February, China announced a strengthened commitment to open up the mandatory third-party auto liability insurance system to foreign-invested insurance companies. China had previously insisted on limiting that market only to domestic Chinese insurers. This served as a significant barrier to other insurers entering the auto market there given that consumers generally purchase various auto coverages as a package from a single insurer and do not buy third-party coverage separately. The announcement followed extensive meetings between Chinese President Hu Jintao and President Obama and most recently, Chinese Vice President Xi Jinping. PCI commends all who were involved on both sides of these discussions, and pledges to work with U.S. government and trade officials and their Chinese counterparts on the development and implementation of this important new policy.

Brazil/Argentina Reinsurance Restrictions. Insurers and reinsurers in the U.S. and abroad are concerned about protectionist measures that have recently been adopted in Brazil and Argentina that place restrictions on risks that ceding insurers in those countries can cede to reinsurers elsewhere. The new restrictions not only deny international reinsurers full access to both markets but also prevent ceding insurers and their consumers in those countries from benefitting from the best rates and coverages available. More importantly, the rules run counter to one of the reinsurance industry's primary objectives, which is to spread risk geographically.

The U.S., the E.U. and Japan have all recently initiated informal discussions with Argentina, which could eventually lead to a formal complaint at the World Trade Organization (WTO). We urge the Congress to monitor developments in this area closely and to work closely with the Administration to keep this issue at the forefront of bilateral or multilateral discussions on financial services trade involving Brazil and Argentina.

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PCI thanks the Subcommittee for this opportunity to offer of perspective on the many international issues now facing the U.S. insurance industry. We will be pleased continue to work with the Subcommittee to provide any further information or assistance that may be needed.