

**THE IMPACT OF INTERNATIONAL REGULATORY  
STANDARDS ON THE COMPETITIVENESS  
OF U.S. INSURERS**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
HOUSING AND INSURANCE  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED FOURTEENTH CONGRESS  
FIRST SESSION

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**THE IMPACT OF INTERNATIONAL  
REGULATORY STANDARDS ON THE  
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**Wednesday, April 29, 2015**

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

The subcommittee met, pursuant to notice, at 10 a.m., in room HVC-210, the Capitol Visitor Center, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Westmoreland, Garrett, Pearce, Hurt, Stivers, Ross, Barr, Rothfus, Williams; Cleaver, Capuano, Green, Beatty, and Kildee.

Ex officio present: Representatives Hensarling and Waters.

Also present: Representative Duffy.

Chairman LUTKEMEYER. The Subcommittee on Housing and Insurance will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. We are going to start just a tad early this morning because we do have some other activities around the Capitol today, so I will get to it in a second here.

Today's hearing is entitled, "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers."

Before we begin, I would like to thank today's witnesses for traveling to HVC-210 for today's hearing. The audio/visual system in the Financial Services Committee's main hearing room is being replaced, and the room is being updated to meet the requirements of the Americans with Disabilities Act. So I want to thank all of you for your patience as we beg, borrow, and steal hearing room space over the next few weeks here. As I go by the hearing room every day, it looks like we are making progress, albeit very, very slowly.

I want to inform the witnesses that the Speaker's office has asked that Members be on the Floor by 10:35 for the joint session of Congress for the Japanese Prime Minister. This subcommittee will recess no later than 10:45 for the joint session. The hearing will reconvene immediately following the Prime Minister's remarks, and I encourage our witnesses and Members to return to the hearing room as quickly as possible.

I now recognize myself for 3 minutes to give an opening statement. First, I want to start by thanking our distinguished witnesses for appearing today. Our Nation enjoys the most robust pol-

icyholder-centric insurance system in the world. The industry performed well during the financial crisis, and policyholders enjoyed the safety and soundness that comes with our Nation's unique regulatory structure.

It is vital that we uphold the system that has served Americans so well for so many generations. Any discussion or compromise that jeopardizes the U.S. insurance industry, or more importantly the policyholder, should be rejected.

This is a complex time for insurance, and while much attention has been paid to international discussions, I want to assure the witnesses that this committee will not lose sight of what is happening domestically, particularly as the Federal Reserve begins the rulemaking process for a domestic capital standard.

It is essential that Federal regulators, who are, as a reminder, subject to congressional legislative action, work with the States and with industry to base any role on the system we have in place today. Then, if appropriate, our representatives to the International Association of Insurance Supervisors (IAIS) can export our insurer-and-policyholder-centric model to the international insurance community.

The United States finds itself with the opportunity to lead and not be led. We must seize the opportunity. It is vital that the gentlemen appearing today work in concert and in the interest of the United States to ensure that no ground is ceded to foreign regulators and that the necessary time is taken to produce common-sense rules.

International conversations taking place at the IAIS continue to cause consternation in the industry. It is my hope that today's hearing will help calm those fears, and that our witnesses will be forthcoming and give this committee a clear vision of where we are headed and when we will get there.

I look forward to today's testimony and I thank our witnesses for attending. With that, I yield 5 minutes to the ranking member of the subcommittee, the gentleman from Missouri, Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman, and thank you for the hearing.

This probably doesn't happen much, but I would like to associate myself with the comments of the chairman. I think he pretty much set the tone for the hearing. I recognize that the G20 has, in fact, continued to push for the strengthening of the international regulatory regime. And I, like my colleague from Missouri, would like to make sure that there is a minimum of regulatory burden on the insurance industry. After all, the problems that generated the 2007-2008 economic collapse were not generated by the insurance industry.

At the same time, we have to make sure that we don't end up with inconsistent requirements across 50 separate jurisdictions that could negatively impact the industry.

So I yield back my time and hope that this will be one of those times when everybody works together for a common solution to a problem that I think even industry would like to see some unity on.

I yield back.

Chairman LUETKEMEYER. I thank the gentleman.

And with that, we welcome the testimony of our witnesses today. We have Mr. Michael McRaith, Director of the Federal Insurance Office, at the U.S. Department of the Treasury; Mr. Mark Van Der Weide, Deputy Director, Division of Banking Supervision and Regulation, at the Federal Reserve Board of Governors; and Mr. Kevin McCarty, Commissioner, Florida Insurance Department, who is testifying on behalf of the NAIC.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

If you are not familiar with the box in front of you, green means start; yellow means you have 1 minute left; and red means that is it. We will try and keep our questions succinct up here.

But with that, Mr. McRaith, you are recognized for 5 minutes. Thank you.

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

Mr. MCRAITH. Thank you, Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee for the invitation and the opportunity to join you today. I am pleased to be here with my fellow panelists.

We released the FIO's second annual report on the insurance industry in September 2014. The report cited 2013 data showing the U.S. industry reported record surplus levels of approximately \$990 billion. Non-health insurers in 2013 collected more than \$1.1 trillion in premium, nearly 7 percent of U.S. GDP.

The report also cites data showing that private market volume is increasing dramatically in developing countries. For example, China's private insurance market increased by more than \$137 billion in the last 5 years, South Korea by nearly \$50 billion in that same period, and Brazil by more than \$41 billion.

These facts illustrate the globalization of the insurance market and explain the increased focus on global standards. For this reason, among others, FIO has a statutory role to coordinate and develop Federal policy on prudential aspects of international insurance matters, including representing the United States at the International Association of Insurance Supervisors (IAIS).

In this work, we collaborate extensively with our colleagues at the Federal Reserve and my former colleagues at the State regulatory system, including my two colleagues on this panel. Our multi-part supervisory structure must be coordinated in order for the United States to assert leadership in international developments. That is exactly what happens today.

International insurance standards are not new. The IAIS was formed in 1994, and State regulators were among the founding members. International standards reflect best practices based on the collective analysis and judgment of the participants. Importantly, international standards are not self-executing in the United States. Federal and State authorities will study, test, and analyze the potential value and impact of any international standard prior to implementation.

The United States has the most diverse and competitive insurance market in the world, with insurers that operate in one part of one State and insurers that are multinational and engaged in a variety of financial services. With this in mind, we work with our international counterparts to build a global consensus that works for the United States. Simply put, international standards must, when implemented, serve the interest of U.S. consumers and industry and the national economy.

The IAIS recently completed structural reform. These changes eliminated the pay-for-play dynamic and increased the IAIS's transparency and independence. No longer will the IAIS depend upon the \$20,400 annual fee paid by industry observers. Now, open meetings and information will be available to all stakeholders, not just those who can afford the annual fee.

Consultation with stakeholders will be more rigorous and uniform. After 12 months of extensive public consideration, in 2015 the IAIS implemented a better approach to both governance and transparency. At the Federal Insurance Office we continue to create opportunities for stakeholders to meet in one place with all U.S. IAIS participants.

In 2015, we have continued with the EU–U.S. insurance project. The EU and the U.S. are two important jurisdictions, both as markets and as homes for insurers. With the collaboration of State regulators, we have worked with our EU counterparts to improve understanding and, where appropriate, consistency and compatibility.

One objective identified in the project is a covered agreement. Not a trade agreement, a covered agreement is an agreement between the United States and another country involving prudential insurance measures. We look forward to engaging with this committee before and during the negotiations of a covered agreement.

The U.S. market and its oversight are unique. Through effective collaboration at home and abroad, U.S. authorities will continue to provide leadership that complements our shared interest in a vibrant, well-regulated market that promotes competition and financial stability and protects consumers. And finally, in all of our work, internationally and domestically, Treasury priorities will remain the best interest of U.S. consumers and insurers, the U.S. economy, and jobs for the American people.

Thank you for your attention. I look forward to your questions. [The prepared statement of Director McRaith can be found on page 44 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. McRaith.

Mr. Van Der Weide, you are recognized for 5 minutes.

**STATEMENT OF MARK E. VAN DER WEIDE, DEPUTY DIRECTOR,  
DIVISION OF BANKING SUPERVISION AND REGULATION,  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Mr. VAN DER WEIDE. Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee, thank you for inviting me to testify on behalf of the Federal Reserve. The Federal Reserve welcomes the opportunity to participate in today's hearing, and I am pleased to be joined by my colleagues from the FIO and the NAIC. While we each have our own unique authority and mission

to carry out, we remain committed to working collaboratively on a wide range of international and domestic insurance issues.

With the enactment of the Dodd-Frank Act, the Federal Reserve assumed responsibility as the consolidated supervisor of insurance holding companies that own banks or thrifts, as well as insurance holding companies designated by the Financial Stability Oversight Council (FSOC). Since the passage of the Act, we have been hard at work creating a supervisory framework that is appropriate for the insurance groups that we oversee. Our principal supervisory objectives for the insurance holding companies that we oversee are protecting the safety and soundness of the consolidated firm and their subsidiary depository institutions, while at the same time mitigating any risks to financial stability. We conduct our consolidated supervision of these firms in coordination with State insurance regulators, who continue their established oversight of the insurance legal entities.

Congress recently amended the Dodd-Frank Act to enable the Federal Reserve to focus on constructing a domestic regulatory capital framework for our supervised insurance firms that is well-tailored to the business of insurance. Since the passage of this amendment to the Dodd-Frank Act, the Fed has been engaging extensively with insurance supervisors and insurance firms, to solicit views on the various approaches to the development of an appropriate consolidated capital regime for insurance holding companies.

We are committed to continuing this engagement and following formal notice and comment processes as we move forward on our insurance capital work.

The Federal Reserve is also participating in the development of international insurance standards. Some of the insurance holding companies that we supervise are internationally active firms that compete with global insurers to provide insurance products to businesses and consumers around the world. Accordingly, in November 2013 the Fed joined our State insurance supervisory colleagues from the NAIC and FIO and became members of the International Association of Insurance Supervisors, or IAIS.

Through our membership in the IAIS, the Fed has been and will continue to be engaged in the development of global standards for regulating and supervising internationally active insurers. As a general proposition, we believe in the utility of having effective global standards for global financial firms. When implemented consistently across jurisdictions, such standards can help provide a level playing field for global firms, can help limit regulatory arbitrage and jurisdiction shopping, and can promote financial stability.

Since joining the IAIS in late 2013, the Fed has been an active participant in several key committees, working groups and work streams. Throughout our first year-and-a-half as a member of the organization, and consistent with our statutory mandate, we have been particularly focused on the financial stability and consolidated supervision work of the IAIS.

One of the key strategic priorities of the IAIS is the development of a supervisory framework and consolidated capital framework for internationally active insurance groups. The Fed has supported the construction of group-wide supervisory frameworks and consoli-

dated capital standards for international insurance groups, so long as they are transparently developed, well-tailored to the U.S. insurance risks, properly calibrated, and complementary to our insurance standards at the legal entity level.

A second focus of the IAIS involves the identification of global systemically important insurers (G-SIIs), and the design of an enhanced regulatory and supervisory framework for G-SIIs. It is important to note that any standards adopted by the IAIS are not binding on the Fed, the FIO, State insurance regulators, or any U.S. insurance company.

And during the buildout of standards for global insurance firms, the Fed will work to ensure that the standards do not conflict with U.S. law and are appropriate for U.S. insurance markets, U.S. insurance firms, and U.S. insurance consumers. Moreover, the Fed would only adopt IAIS regulatory standards after following the well-established rulemaking protocols under U.S. law, which include a transparent process for proposal issuance, solicitation of public comment, and rule finalization.

The Federal Reserve has acted and will continue to act on the international insurance stage in an engaged partnership with our colleagues from the FIO, the State insurance commissioners, and the NAIC. Our multi-party dialogue strives to develop a central Team USA position on the most critical matters of global insurance policy. The Fed will also continue to actively engage with the U.S. insurance industry to help ensure that any global insurance regulatory standards work well for U.S.-based firms.

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

[The prepared statement of Deputy Director Van Der Weide can be found on page 52 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Van Der Weide.

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

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

Mr. MCCARTY. Good morning, Chairman Luetkemeyer and Ranking Member Cleaver. Thank you for the invitation to testify here on behalf of the NAIC.

The U.S. insurance market is the largest and most competitive in the world. Taken individually, U.S. States make up about half of the world's 50 largest insurance markets. My State, the State of Florida, for example, is the 12th largest insurance jurisdiction in the world.

State regulators cooperate closely on a regular basis to provide leadership on global insurance issues and activities with a focus on policyholder protection and maintaining stable and competitive markets. As capital rules for insurers are developed, State regulators continue to oppose a one-size-fits-all bankcentric set of regulations and focus instead on the importance of company- and product-specific analysis and examination.

Capital requirements are important, but if imposed incorrectly or without regard to differences in products and institutions, they can be onerous to companies, be harmful to policyholders, and can even encourage new risk-taking in the insurance industry. Any capital requirement must be adaptable to our markets and benefit our consumers.

It is also important to keep in mind that any new standards are in addition to and not in lieu of State risk-based capital requirements applicable to insurers within the group. The IAIS is developing capital proposals for internationally active groups, including many firms that are based in the United States. We have serious concerns about the process and the aggressive timeline given the legal, regulatory, and accounting differences around the globe.

All the same, we are fully engaged in the process to ensure that any standard appropriately reflects the risk characteristics of the underlying business and does not lead to unintended consequences such as limiting products available to consumers, or stagnating growth, jobs, and innovation. We will not implement any international standard that is inconsistent with our time-tested solvency regime that puts policyholders first.

Critical to the credibility of the decision-making of the IAIS is an all-inclusive and transparent process. While we agree that the pay-to-play structure needed to be reformed, we believe there was a less intrusive way to accomplish that goal. We will continue to advocate for increased transparency and to encourage our colleagues in the Federal Government to do the same.

We are also concerned with the lack of transparency at the Financial Stability Board (FSB). We have had only limited access to FSB discussions directly relevant to the very sector that we regulate. What little participation we do have only occurs as a representative of the IAIS, even after requesting inclusion from our FSB representatives in the United States. We find the lack of support for our inclusion by our Federal colleagues troubling and not in the best interest of U.S. insurers and, more importantly, of our policyholders.

For our part, the NAIC has longstanding procedures and ongoing responsibilities to seek input from consumers and other interested parties. We will continue working on these issues through an open and transparent NAIC process. To that end, last year the NAIC formed a working group, which I chair, to provide ongoing review of ComFrame and international group capital developments. We are also exploring group capital concepts appropriate for U.S.-based internationally active groups, and we have provided comprehensive feedback to the IAIS regarding the proposed ICS.

State insurance regulators have also been actively involved in the EU-U.S. dialogue project, which is designed to achieve a better mutual understanding of the regulatory approaches used by the United States and by Europe. A core issue of discussion has been Europe's call for reduction in our reinsurance collateral requirements. State regulators have worked to develop an approach by which collateral can be reduced in a consistent manner, commensurate with the financial strength of the reinsurer and the nature of the regulatory regime that oversees it.

By year-end, we anticipate 37 States representing 93 percent of the premium in the United States will have adopted this approach. In spite of this action, Treasury has expressed an interest in exploring discussions with the EU on a potential preemptive covered agreement. Given the progress we have made, the NAIC is not convinced that a covered agreement is necessary. While we will continue to engage Treasury and the USTR on this issue, and would expect to be directly involved in these deliberations, we believe pre-emption of State law by Federal agencies should always be a last resort.

In conclusion, State insurance regulators have a strong track record of effective collaboration and supervision. We remain committed to coordinating with our Federal partners. We also take seriously our obligation to engage internationally in those areas that impact the U.S. economy, companies, and consumers. State-based regulation is always evolving to meet challenges posed by dynamic markets, and we continue to believe that well-regulated markets at home and abroad make for well-protected policyholders.

Thank you again for the opportunity to be here on behalf of the NAIC. Thank you.

[The prepared statement of Commissioner McCarty can be found on page 38 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. McCarty.

And I thank all of the witnesses for your testimony this morning. It was very insightful.

And with that, I recognize myself for 5 minutes for questions.

Mr. McRaith, there has been much discussion surrounding the timeline with regard to international capital standards at the IAIS. And while U.S. representatives at the IAIS have indicated the process is slowing, we hear many reports that European regulators are moving ahead, in fact, conflicting reports with regard to depending on who you talk to here in this country.

Can you give us an idea on the timing on this issue, from your perspective?

Mr. McRAITH. The international community is moving forward with the development of capital standards that will promote convergence over a long period of time. What exactly that period of time is, no one knows at this point. What we do know is that in February of this year, the international participants at the IAIS, frankly led by our office with the support of the Federal Reserve and State regulators, negotiated as an international community what do we mean in terms of our goal and our timeline.

And what we said was, we want to move forward incrementally, in small steps. This is something that will take a long period of time because the differences country to country are extremely significant and we need to be extremely mindful of potential negative unintended consequences as we move forward.

Chairman LUETKEMEYER. Mr. McCarty, what is your view of the timeline? You are around the negotiations as well.

Mr. McCARTY. Given that risk-based capital took over a decade to develop in the United States, and about a decade or more to develop solvency to, the original timeline of 18 months seemed overly aggressive to impose a global capital standard throughout all the regions of the world.

What Director McRaith is referring to, I think, was a very important achievement. There was agreement in the meeting in February by the IAIS to look for what would an ultimate goal look like without setting a timeline. However, it is important to point out that the committee structures are still being very aggressive, and my concern about the aggressive timeline with regard to the committee structure is that I am concerned that a certain amount of field testing might get shortchanged in the process.

For instance, we want to make sure that we have ample time to test things like the GAAP plus approach and timelines other than a 1-year timeline. I think it is important, given the very significant impact this may have on American companies and consumers, that sufficient time is allowed for us to field test and test the different variables that are out there to ensure that we have a product that encompasses the U.S. regulatory framework.

Chairman LUETKEMEYER. Do you believe that your point of view and your concerns are being heard and addressed and are being taken seriously with regard to these negotiations?

Mr. McCARTY. We certainly have expressed this from the very beginning. I think that the Chair and the members of the committee understand our concern. I am just concerned somewhat about the progress that is being made in the committee structure. While this is a determination that has been made by the executive committee to set an ultimate goal, it really hasn't slowed down the pace going forward with regard to meeting guidelines for 2016.

Chairman LUETKEMEYER. Mr. Van Der Weide, are you comfortable with the negotiations at this point? And what are your concerns or opinions with regard to the timeline on capital standards? Do you have any concerns about that at all? I know you say in your written testimony that you want to continue to work with a policy-centered type of approach that we have here in this country. But what are your views?

Mr. VAN DER WEIDE. I would agree with my colleagues that it is important to get the global insurance capital standard right, and it is more important to get it done right than to get it done quickly. It is a pretty complicated endeavor with lots of moving parts. We need to make sure that the rule works for all of the major insurance jurisdictions around the world.

I think the IAIS is going to operate in a deliberate fashion with multiple rounds of consultation on their proposals. I think that is the right path. I think it will take the IAIS several years to get that capital standard developed, and there will be a multi-year implementation period as well for each national jurisdiction.

We need to continue as the U.S. representatives on the IAIS to make sure that is the case, that the IAIS focuses on getting the standard right and does not excessively hasten towards that conclusion.

Chairman LUETKEMEYER. Very good. Thank you.

Mr. McRaith, my time is very limited, so I just have a couple of comments. You and I have had this discussion before, and I made the comment that you are an advocate and a mediator, not a regulator, and we want to continue to hope that you stress that position and continue down that road.

I understand that you had a recent meeting over in Italy; is that correct?

Mr. MCRAITH. I was not personally—

Chairman LUETKEMEYER. Oh, okay.

Mr. MCRAITH. There was an IAIS technical group, working group meetings and public session in Italy recently, yes.

Chairman LUETKEMEYER. Okay. I just want to get your commitment that when you do have these international meetings, you will work in concert with my office and this committee to make sure we have the updated, most current information with regard to what went on in those meetings so we can be reactive and be supportive as we need to be.

Mr. MCRAITH. Mr. Chairman, we welcome the opportunity to engage with you and members of the committee.

Chairman LUETKEMEYER. Thank you very much.

With that, I yield to Mr. Capuano for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. Thank you for yielding.

Gentlemen, thank you for coming. Could any of you point out to me the law, the Federal law, the United States Federal law that empowers you to regulate non-SIFI (systemically important financial institution) insurance companies? Could you cite that law to me?

Mr. VAN DER WEIDE. The Federal Reserve under the Dodd-Frank Act, the Bank Holding Company Act, and the Home Owners' Loan Act has authority, in addition to regulating the non-bank SIFIs that have been designated by FSOC that engage in insurance—

Mr. CAPUANO. There are three insurance companies that are SIFIs.

Mr. VAN DER WEIDE. Correct.

Mr. CAPUANO. And those are the three you can regulate?

Mr. VAN DER WEIDE. Yes. But in addition to SIFIs, we are required by law to regulate any firm that owns a depository institution.

Mr. CAPUANO. Right.

Mr. VAN DER WEIDE. A bank or thrift and several other—

Mr. CAPUANO. Can you point to me the law that empowers any United States Federal agency at the Federal level to regulate a non-SIFI, non-bank-owning insurance company? I didn't think so. Because there isn't one. And yet, you are negotiating as if there is.

Now, the thing that is amazing to me is that I would argue there is a lot of work to do here.

Mr. McRaith, you have been before us many times. I hope you count me as one of your defenders and supporters. I think FIO's work is critically important, and I will clearly state that I have been a supporter of an optional Federal charter—I know that gets some people all worked up, and I will get phone calls tomorrow. But I always emphasize the word "optional," but that is a different issue—which would then allow companies to choose to be regulated at the Federal level.

Now, we don't have that yet. Why are you negotiating for Federal standards for companies you cannot enforce regulations on?

Mr. MCRAITH. Congressman, the work at the IAIS is the development of standards. It is independent of the regulatory structure in

any one country. So in this work, as we represent the United States and work closely with our State colleagues—you will remember, I was the intern inspector for a long time in Illinois and worked with our Federal Reserve colleagues—our objective is to influence the consensus internationally so that it reflects and integrates the best interests of the United States. As those standards are developed, they are then implemented at the State level or in some cases at the Federal level.

Mr. CAPUANO. So you are hoping that the State levels will adopt your work. So this is at the moment an academic endeavor, which is not necessarily un-worthwhile. But in the final analysis, after all the work that you do at the IAIS, it will apply to three insurance companies; is that a fair conclusion?

And I understand you hope that these States will do it, and I am happy to work with anyone who wants to talk about an optional Federal charter, but at the moment it would apply to three insurance companies.

Mr. MCRAITH. The international standards have been around since 1994, and the States have implemented those international standards in a way that reflects the State approach—

Mr. CAPUANO. So you are suggesting that the IAIS is something along the lines of a model law, trying to do best practices to suggest, to help our State friends see the light?

Mr. MCRAITH. I think the IAIS's mission is to promote global financial stability and promote best practices and supervision globally.

Mr. CAPUANO. I respect that, but first of all, they have no record of doing so, because I don't think they have done such a great job. Now, don't get me wrong, I think some of our State regulators haven't done such a great job. I kind of remember a little problem with AIG, but that is a different issue.

What I do think is that if we are going to have Federal regulations, which I don't oppose, then you need to come to Congress and say, "We want to have Federal regulations on insurance companies." We will have that debate. We will see if you have the support, and if you do, we will do it. But if you don't, I kind of think there is a lot of other things that you should be doing, Mr. McRaith, and certainly a lot of things the Fed should be doing that matter.

Now, I have no problem going to conferences and discussing a United States perspective on various items, but I have to tell you, everything I have read from the IAIS certainly looks like they expect us to just adopt it the day after it is done. And I understand you don't want to say that, but I want to say it really clearly to those friends at the IAIS. We love you. We respect you. We want to work with you. But you are not telling us what to do.

In the final analysis, it will be the United States that makes the decision what happens to the U.S. companies, not other people. And, again, if we want to talk about it in the long run, great idea. But I think it is going to be sad. And I have to tell you, from the testimony, if you read the testimony, there are a few things that say that, but most of the testimony presumes that it is going to be adopted.

And I just think it is very important to put on the record that, again, good exercise, no problem with the discussions. I have a real problem with pretending or presuming or letting it go unspoken that in the final analysis, this could all be for nothing.

Thank you, Mr. Chairman, for your indulgence.

Chairman LUETKEMEYER. I thank the gentleman. His time has expired.

With that, we go to the gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. GARRETT. Good morning. I probably eventually will get along the same line as the gentleman from Massachusetts, but—

Mr. CAPUANO. Oh, my God, Mr. Chairman. I would like to change my—

Chairman LUETKEMEYER. We are all in trouble if we associate ourselves with your remarks, Mr. Capuano. Although today, I am tempted to do so myself. I have to take my temperature here.

Mr. GARRETT. I just want to start someplace else, and by that time maybe I will change my mind.

Mr. Van Der Weide—and this maybe ties into it, given the ongoing efforts in both here in the House and the Senate to bring more accountability and also transparency to the Federal Reserve—I would like to discuss with you in a little more detail the international capital standards and the setting for the IIAG and how it was originally conceived and, as you may have already indicated, how some of this has mutated over time.

My understanding is that the initiative was originally intended, as also indicated, to only be for the global systemically important insurers. Then of course, in 2013 the goal changed. A list of the entities that would be subjected to the standards has been expanded. They now have a new category.

And so it seems to me that the Dodd-Frank process is, in some sense, being circumvented through not a transparent method but through a more opaque, and some would even say secretive international process. At the end of the day, the goal would be to have different standards than what we have right now.

And maybe I will just digress from Mr. Van Der Weide and go to Mr. McRaith. You said, as far as the process to get there, we are going to take small steps. The question is, to what end? If we are going to take small steps or move the ball down the field, I would assume that all of you would have some sort of goal in mind as to what the goal line looks like, what the end model looks like since you also said that we have a dramatically or fundamentally different structures in ours versus the Europeans.

So I will start with you, Mr. McRaith. Have you envisioned or articulated what the end model is or goal is that you are trying to accomplish with these incremental steps? And then, I will go to Mr. Van Der Weide.

Mr. MCRATH. Let me be clear, our work at the IAIS is to integrate the best interests of the United States, the U.S. view, into any global standards. What is driving that, Congressman, is the globalization of the insurance marketplace.

Mr. GARRETT. I get that. But what is the goal at the end of the day? So you integrate something into a model, but at the end, you should have in mind, this is what we are going to strive for, this

is how we are going to integrate it. And at the end of the day, this is what the final product is going to look like. Is that final product going to look like what the American model is today, or is that model going to look like what the European model is today?

Mr. MCRAITH. You are absolutely right, and to echo the comments of Congressman Capuano, whatever is implemented in the United States will be a U.S. approach. It will be done by the States and the Federal Reserve where appropriate.

Mr. GARRETT. So the goal is a U.S. model?

Mr. MCRAITH. That is correct.

Mr. GARRETT. And that is the same goal to which the international body is also agreeing?

Mr. MCRAITH. No. The goal is to establish global standards that reflect and integrate the U.S. interests and impart implementations in the United States.

Mr. GARRETT. Okay. So that is our goal. That is not necessarily their goal. I presume their goal would be a more European model; is that fair to say?

Mr. MCRAITH. In my view, Congressman, at least, and I don't want to speak for the others, but this is driven really more by the developing economies who are welcoming our companies into their markets.

Mr. GARRETT. Yes. But at the end of the day, if you have two teams that are working towards opposite, different goals, I don't understand how you can then come to commonality on it. At the beginning of the day, you have to agree what your goal is going to be. But I only have a minute left.

Mr. McRaith, can you tell us, as we go toward these goals and these models, how were the exact thresholds and metrics used to determine the standards that are being discussed in these discussions? Is there any empirical analysis which shows that companies that fit the metrics that are coming up will pose either more or less risk to it? And if they do pose a risk, what analysis or quantifiable analysis have they looked at to determine that? Either one of you may answer.

Mr. MCRAITH. The capital standard is being developed through extensive feedback and engagement with stakeholders. As Commissioner McCarty referred to in one of his earlier comments, there is field testing. So the firms themselves are directly engaged in providing—

Mr. GARRETT. A quick question, since I only have 10 seconds left, Mr. McRaith, are those exact same standards being done right now through the Fed and the FSOC for the United States? If those standards are good internationally, why do we not have the exact same standards here in the United States?

Mr. MCRAITH. The FSOC—

Mr. GARRETT. I will ask Mr. Van Der Weide, please, to address that.

Mr. VAN DER WEIDE. The FSOC has a very independent process around how it assesses the systemic footprint of the U.S. insurance firms, and it is relatively independent from what the IAIS is doing on its G-SII identification process.

Mr. GARRETT. So what is good for one is not good for the others, is what you are saying?

Mr. VAN DER WEIDE. They each have different goals and purposes.

Mr. GARRETT. Okay. So they have different standards as to what is good and what is bad? Okay.

Mr. VAN DER WEIDE. Yes.

Mr. GARRETT. Was that a "yes?"

Mr. VAN DER WEIDE. Yes, they have different standards. They bear some resemblance to each other, but they are different in many ways.

Mr. GARRETT. It is incredible to try to understand why what is systemically important globally is not systemically important for the United States. I appreciate the testimony, but that is absolutely an incredible testimony. Thank you.

Chairman LUETKEMEYER. Thank you, Mr. Garrett.

With that, we go to the ranking member of the subcommittee, the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I don't have much time. What I would like for each of you to do is to give me one advantage, if you can, of the benefits of international standards, and then with time, I would like you to give me a negative of international standards. So if you could just be as succinct as possible on the benefits?

Mr. VAN DER WEIDE. Sure, I will start on that one. I will be succinct, but I will list off at least two benefits of comparable global international standards for financial firms and insurance firms in particular.

The first is achieving a level playing field across the world. It is important for America, as foreign insurers operate in our market, that they be subject to a regulatory and supervisory regime that is at least as tough as ours. We don't want the foreign companies to be able to compete in the U.S. insurance market on more advantageous terms than our firms can compete. So having that kind of a comparable global playing field on some of the key regulatory and supervisory standards can be helpful from a global level playing field basis.

It can also be helpful to achieve global financial stability to the extent that particular firms have a very large systemic footprint. As a general matter, systemic risk seeks out the place where it is least regulated, and it tends to collect and deposit there and grow. So having a decent floor around the international regulatory standards can prevent those sorts of accumulations of a systemic risk cesspool, so to speak.

But there are some potential downsides of international regulations as well, and I think the key one is if you have international regulation that just doesn't work well for some of the major markets, is not well-tailored to the risks in those markets, that can obviously result in inferior macroeconomic outcomes for those countries whose firms can't use the rule efficiently.

Mr. CLEAVER. Mr. McCarty?

Mr. MCCARTY. I definitely think there is a role for international standards. As Director McRaith has alluded to for over a dozen years, we have had insurance core principles which I think are very valuable for evaluating not only developed country markets but emerging markets as well. More and more of our markets are

gravitating towards Asia and South America, so it is important that they have core principles in place to provide some guidance on how markets should be regulated in those areas.

My concern is not so much on standards but what the implementation of standards, as my colleague has referred to, that are unimplementable, where you are putting in, for instance, a hoisting, for instance, a consolidated capital standard with a group-centric approach like banks use as opposed to more emphasis on a capital adequacy test or a stress test and looking at inter-party transactions in ways to limit risk.

And I think it could be a standard, but it is not the standard that seems to be the preference of our colleagues around the world.

Mr. CLEAVER. Yes. Well, Mr. McRaith, I am not sure you said that but—

Mr. McRAITH. I will reply to your question succinctly.

Mr. CLEAVER. Yes.

Mr. McRAITH. The advantage of global standards is they will promote further opportunities for our companies that are seeking to grow in developing economies in Asia, South America, and Africa. Those supervisors in those countries are looking for common standards, common language. The potential negative is if we, the United States, are not actively engaged in asserting our best practices, our points of view, so that whatever the global standard is, it incorporates, reflects, and integrates the best interests of the United States.

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

Chairman LUETKEMEYER. Thank you. With that, we are going to adjourn for a while. We have the Prime Minister of Japan in today for a joint session of Congress to give an address, and many of our Members would like to attend that. We will reconvene upon his closing remarks, as quickly as possible. I am sure he is a politician like the rest of us, so there is no telling how long he will talk. But we are hopeful that it will be around an hour.

But I would ask everybody, the panel especially, to find your way back here around 10:30 or 10:45 just in case things go short.

With that, the Members are asked to reconvene here upon the conclusion of the Prime Minister's speech. And with that, we will recess.

[recess]

Chairman LUETKEMEYER. Let's reconvene. And as Members keep strolling in, we will keep a running tally of where we go next. I appreciate the indulgence of the panel today. We will begin this afternoon's questioning with the gentleman from Georgia, Mr. Westmoreland, for 5 minutes.

Mr. WESTMORELAND. Thank you, Mr. Chairman. Before I ask my questions, I just want to be the first to thank Mr. Capuano and Mr. Garrett for their questions. And I want to follow along the same lines as my colleagues. I believe neither Mr. McRaith nor Mr. Van Der Weide could cite a relevant Federal law or statute that gives the Federal regulatory authority over non-SIFI, non-bank subsidiary insurance companies. But yet you continue to negotiate international insurance standards that you say will apply to all insurance companies. Now, to my knowledge, we still have State-based insurance regulation. Is that true? "Yes" would be good.

Mr. VAN DER WEIDE. Yes.

Mr. MCRAITH. Yes.

Mr. WESTMORELAND. If you have no regulatory authority over 99 percent of United States insurers, what do you tell your international partners about your ability to enforce the rules you agree with in our country? How do you explain that?

Mr. MCRAITH. Congressman, the first thing that we wanted—let me start at the beginning, if I may. International standards are not only for the United States. As I mentioned before the break, other countries are looking to the global standards to implement in their countries. So our mission is to shape those standards in a way that reflects the perspectives of the State regulators, the Federal Reserve, and the best interests of the United States.

Mr. WESTMORELAND. What business do you have telling other countries how to regulate when you don't have any regulation over 99 percent of the insurance companies here?

Mr. MCRAITH. It is important to understand that the international standard-setting process is very much a global and consensus-driven process. The State regulators are, of course, very involved, and the Federal Reserve. It is consensus-driven. The goals are to promote financial stability globally. As we learned through the crisis, national economies around the globe are connected and affect one another.

Mr. WESTMORELAND. Are any of these companies SIFIs? Are they a problem? Are they a threat to our economy?

Mr. MCRAITH. Forgive me, Congressman, I am not sure I understand your question.

Mr. WESTMORELAND. You are talking about financial stability, worldwide financial stability. How do these insurance companies play into that? They are not banks.

Mr. MCRAITH. That is correct. Insurance companies are very significant participants in global and national capital markets. They are essential participants in financial services. The firms that are looked at for global purposes are firms that are massive, complex, sophisticated enterprises that are engaged in a variety of financial activities around the world.

Mr. WESTMORELAND. I am going to go back to the original question. How do you explain to the people, the Europeans or the rest of the world, how you are going to participate in effecting standards for their insurance companies to operate under, when you don't have any control over 99 percent of the insurance companies in this country? I am a little slow—I am from the South—and I understand that. But I am just having a hard time getting that. And Mr. Van Der Weide, if you want to jump in there at any time, I would love to hear from you.

Mr. VAN DER WEIDE. Sure. Thank you. As you know, we collectively, the States and the Federal Reserve and the FIO, negotiate the international insurance standards at the IAIS level. And as Director McRaith said, we are attempting to do that to advance the interests of the United States. The other countries around the table understand generally how the U.S. insurance system works. They understand it is primarily regulated by the States, and that the vast, vast majority of insurance companies are regulated only at the State level, and that the Federal Reserve only has a handful

of holding companies that it supervises on a consolidated basis. So they understand that. But in our negotiations, we are attempting to make sure that the interests of the NAIC, the Federal Reserve, and also the FIO are reflected. And we are trying to make those agreements in America's best interests.

Mr. WESTMORELAND. I know my time is just about up, Mr. Chairman, but Mr. McCarty, could you respond to my question? Maybe you can help me out a little bit.

Mr. MCCARTY. Yes. The NAIC was a founding member of the IAIS. And we thought it would be very productive for insurance regulators in the United States and around the world to work together collaboratively, cooperatively, looking at ways of looking at risks, how we could supervise, set some basic insurance core principles for the developing world, the developing nations. But the genesis, the initial genesis was to be a sharing of ideas, learning, looking at best practices, perhaps improving our own practices back home by looking at how practices are done around the world.

Insurance is very different, as you know, from banking. It is very specific to an individual country and jurisdiction and products. And so, we use it as an opportunity. Over time, the IAIS, through the FSB, has been tasked with responsibilities of setting global capital standards. Obviously, that will have a great impact on our country. For my purposes, in the State of Florida, I get 80 percent of my reinsurance from global capital companies. So it is very important to me what standards are being set. Since we do supervise 100 percent of the private insurance market in the United States, we think it is important that we have a role in discussing these issues and what impact they may directly have or indirectly have on our consumers of the United States, on our insurance firms, and of course back home to the people of Florida.

Mr. WESTMORELAND. Thank you. And my time has expired. But I hope we will do one more round. Thank you.

Chairman LUETKEMEYER. I thank the gentleman. With that, we go to Mr. Williams, the gentleman from Texas.

Mr. WILLIAMS. Thank you, Mr. Chairman. Thank you all for being here today. I am a small business owner, and have been for about—well, my family has been for 75 years. I am in the car business. I am a car dealer. I have to buy a lot of insurance. And I believe in the private sector. Listening to some of this testimony today, I am worried to death about it. Am I going to have to deal with somebody overseas telling me how to—what I need to insure my cars for and this and that, rather than my local insurance person? It really has me concerned.

And the other thing, in listening to the testimony, I am concerned that you, Mr. McCarty, who actually represents me in this dialogue, are not really not at the table. You really don't have much to say. And that bothers me because I am a customer, I live with this every day, and I am concerned of where we are going forward, as you have heard, with a dialogue that you really don't represent anybody to have conversations with. So with that being said, let me say this, and I will address my questions to you, Mr. McCarty. The United States' regulatory system, I think we all agree, is very different than what we see in Europe and in other international markets. What do you see as the paramount interest

of the United States when it is involved in negotiations, discussions with these international regulatory groups? I think you can probably be pretty simple on that.

Mr. MCCARTY. Yes. I obviously share your concern about what potential impact global standards would have. On the local—

Mr. WILLIAMS. I don't speak German, I don't speak Italian.

Mr. MCCARTY. Yes. And that is why it is very important for the U.S. team, all of us, the Federal Reserve, FIO, and of course the regulator, to be partners at the table and to make sure that whatever standards are being set do not have any detrimental impact on our companies. Our companies not only do business in America, but do business abroad, where more and more insurance is being sold. Our concern, I think from a State regulator perspective, is that there really isn't a voice at the FSB representing insurance interests. We respect our colleagues from the other financial sectors who are on that, but it would really be in the best interests of American companies and American consumers to have the regulators who regulate insurance actually have a voice on the FSB.

Mr. WILLIAMS. I agree. Would you say it is the job of the FIO Director to represent the interests of the State regulators?

Mr. MCCARTY. My understanding of Dodd-Frank is that the role of the Federal Insurance Office Director is to represent the United States at the IAIS as appropriate. I think that is specific in law. I think the NAIC by and through its Directors and commissioners and staff members participate in all levels of the IAIS. The Federal Insurance Office does not regulate insurance, the State regulators do, but the FIO does have a role as specified under Dodd-Frank. And I think it is important to understand that while we have our differences because we come from different perspectives and views, we all work very collaboratively, and we try to have a unified U.S. team approach. And we do the best we can to achieve that to make sure that folks, small businesses back home are protected.

Mr. WILLIAMS. It would work really well if you were there, having a voice. As a representative of the State regulators, do you and the FIO Director share the same goals, to advance the interests of the U.S. insurance industry and State regulators?

Mr. MCCARTY. I have known Director McRaith for a number of years, and we have had a number of conversations. We have different approaches. We have an approach at the NAIC, as you may be aware, a very transparent process for open discussion and dialogue, pros and cons of developing positions. The Federal Reserve and the FIO are culturally different in that regard in how they make those. In my conversations with Director McRaith, I am very confident that he is very concerned about the role of American companies, and is only interested in going forward with what would protect the consumers of the United States. And that has been my best impression.

Mr. WILLIAMS. My last question, quickly, given that the U.S. insurers are regulated by the 50 States rather than one Federal or national entity, what do you think is the proper role of the State insurance commissioners in these international settings in terms of complementing the FIO Director?

Mr. MCCARTY. I do believe, as the regulators—I come from Florida, and I speak for Florida, and I also speak on behalf of the

NAIC, and we do have a process for granting that authority. But by and large, we are still viewed as individual States. I think our voice in terms of what is appropriate in terms of establishing standards for insurance, whether it is capital standards or group supervision, et cetera, our opinion should be central to that discussion.

But we certainly understand the role that has been given by the Congress to the FIO, and of course our partners with the Federal Reserve who are now also joining us at the IAIS. And we are working as best we can to make this an effective and efficient way of protecting American businesses and American consumers.

Mr. WILLIAMS. Thank you for your testimony. Mr. Chairman, I yield back.

Chairman LUETKEMEYER. Thank you. The gentleman yields back. And with that, we go to the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. And thank you to the witnesses for your testimony today. Mr. Van Der Weide, I have a question for you relating to the Fed's participation in FSOC and SIFI designations for insurers, and particularly these global systemically important insurers. My question is, what criteria were used to designate the three insurers as SIFIs?

Mr. VAN DER WEIDE. The FSOC publicizes a summary of its decision whenever it designates a non-bank SIFI. And that was true as well for the three insurance non-bank SIFIs that the FSOC has designated. They have also put out a public framework to describe the factors that they used to assess whether a particular non-bank financial firm is a SIFI. And those procedures were followed in the process that led to the designation of the three U.S. insurers as non-bank SIFIs.

I think the FSOC recognizes that traditional insurance activities tend to generate low amounts of systemic risk. But there are a fair amount of nontraditional insurance activities that are engaged in by those three firms, and those did generate some amounts of systemic risk. Some of the key factors that were cited in the FSOC's decisions included the extent of short-term funding activities at those organizations, the extent of their capital markets activities—repos, securities, lending, OTC derivatives—which create interconnectedness with the rest of the financial system, and also the runnable liabilities of some of those firms embedded in their insurance or annuities products, which would enable the annuitant or the insurance policyholder to potentially take out its money from the firm on short notice. But those are some of the factors that—

Mr. BARR. When you published the findings and the designations, did you discuss the extent to which those factors or those activities that you deemed to be more risky or systemically relevant—were there criteria that would send a signal to the insurance marketplace what a firm, a systemically important insurance company could do to derisk to escape the SIFI designation?

Mr. VAN DER WEIDE. Yes, the firms were informed at a deeper level beyond the public document—

Mr. BARR. And I will just interject here if you don't mind, just because it is the input from those designated firms and others in the insurance industry that there is a lack of clarity, a significant

lack of clarity as to those criteria and those factors and what is required of those firms to derisk sufficiently to be de-designated, if you will, from the SIFI status.

Mr. VAN DER WEIDE. Right. Each of the three firms was given a much more detailed private explanation for the factors that the FSOC felt were indicative of their SIFI status. So I think they do have a pretty good sense of the kinds of elements of their balance sheets and business operations that did result in the FSOC's decisions. I do agree with you that it is very important that there be a potential de-designation process. It is not meant to be a "Hotel California" stay, and it is important that the FSOC carry out its annual reevaluation process, which is written into statute, and to give each of the companies a chance to go through that process.

Mr. BARR. Thank you for that answer. A quick follow-up: As you know, the G-20 directed the FSB to identify global systemically important banks (G-SIBs) that would be subject to these international capital requirements. And my question would be did the G-20's work have any bearing or influence on domestic regulators' SIFI determinations, or is there any connection there?

Mr. VAN DER WEIDE. No, they were very independent processes. I believe the FSOC designated a firm first, and then the FSB made their decisions for the entire set of global insurers and picked out three U.S. insurers, and then the FSOC came back and did two more later. But the processes were quite independent, and the approaches that the two organizations take, the FSOC and the FSB, were different. They are obviously looking at some of the same factors, but they have different approaches as to how they assess the systemic footprint of an individual firm. For example, the IAIS methodology is a little bit more algorithmic or formulaic, the FSOC's approach is a little more firm-specific judgmental. But the—

Mr. BARR. Let me ask you a question. I don't have much time. Are the three firms that were designated SIFIs by FSOC internationally active insurance groups?

Mr. VAN DER WEIDE. Yes.

Mr. BARR. So they would be subject to this process. So you are saying you have independent and conflicting processes, one international, but you have an independent domestic designation process.

Mr. VAN DER WEIDE. I don't think they were conflicting, but they were independent processes.

Mr. BARR. Okay. Really quick to Mr. McCarty, you indicated that preserving regulatory independence and diversity can serve as a buffer against contagion. Can you elaborate really quickly on that?

Mr. MCCARTY. Absolutely. I think for all intents and purposes, if you look at insurance, the diversification of risk actually helps minimize systemic risk. And our concern is, as we move and move more towards a global capital standards and have a common assessment of risk, a common assessment of assets, that we are actually moving more towards emphasizing and potentially exacerbating systemic risk than getting away from it. So we think that a more jurisdictionally-based approach would be more prudent in minimizing risk.

And if I could make just one quick comment about the FSOC, we are very concerned about the designation process, the transparency in the process, and making sure that the regulators that regulate insurance understand. Because one of the ways we can address this is we can put more regulation, more policy measures, more capital, or another approach we can take is to take away some of that risk. Finding out ways of eliminating risk. The last financial crisis we didn't—I know what risks were out there. One of the roles FSOC can play is to help us identify those risks and help companies eliminate that risk so we are not necessarily exacerbating a situation and not just trying to address it through more regulation and more capital.

Mr. BARR. Thank you. I yield back.

Chairman LUETKEMEYER. Thank you. Mr. Van Der Weide, I want to let you know that you gave us more information in your 2 or 3 minutes' response here than all of the other folks we have had before this committee, put together, when we asked that question about SIFIs. Thank you for your response.

Next up is the gentleman from Florida, Mr. Ross. And then after that, Mr. Green wants to participate. So we will start with Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman. And gentlemen, thank you all for being here. I want to follow up on what Commissioner McCarty was talking about with regard to SIFI designations, especially for non-bank financial institutions. And I must put in a plug for a bill that I have filed that asked for the transparency for that particular designation not only as to why they got in there, but how they can get in there, and how frequently they can seek to get out of there. I also want to put in a plug, because I have dealt with the NAIC. And I am grateful to you, Commissioner, and to Senator Nelson, who is also here, for the efforts that you have given to me with regard to private flood insurance, because I think it is very important for consumers out there to have that option. And also with regard to another bill, also bipartisan, dealing with disaster savings accounts. As we are on the cusp of hurricane season starting May 1st, the more that we can incentivize private customers getting in and mitigating their structures, we know that for every \$1 spent in mitigation, we save \$3 in relief. And so, I give that out as a commercial public statement there.

But now I want to get back into why you guys are here. Commissioner, let me ask you something. With regard to the international capital standards, assume, if you will, that they are passed and that they are imposed on the individual States, which would require maybe even putting more capital—set aside more capital, maybe some more costs of compliance, but anyway a greater cost. Is this something that as an insurance commissioner, you would expect to be allowed to be recovered in the rate that ultimately would have to be paid for by the consumer?

Mr. MCCARTY. Yes. And actually, it is a little more complicated than that. Because if you do impose a capital standard, let's say it is a capital standard that is more in line with what we are seeing from a European model as opposed to what we would say is a capital adequacy model, which we would be advocating, there are many complications. One is that you run the risk of less products,

because less products would be seen as viable under a different capital regime. That may punish longer-term products that many American companies sell, particularly in the annuities marketplace. You would see some disruption in the marketplace because you have visions of some winners and losers. And some of the people would gravitate to those companies that have the higher capital standards, which could cause disruption in the marketplace and unintended consequences.

There is also the potential of other unintended consequences such as stagnation of growth, less products available, and less senior products available in particular. So there are a lot of things that we have to take into consideration that would cause unintended disruptions in the marketplace.

Mr. ROSS. Mr. Van Der Weide, are any of these studies that you may have conducted in analyzing the impact of the IAIS capital standards?

Mr. VAN DER WEIDE. The IAIS capital standards are very much still in development. At this point, the IAIS has not even settled on a basic kind of framework for how they would approach—

Mr. ROSS. But you would agree that there should be some type of impact study of—

Mr. VAN DER WEIDE. Yes, absolutely. We think the IAIS should be doing impact studies. And before we do any implementation of any international standards, we also need to do a very detailed amount of cost-benefit analysis to make sure they work for our country, for our insurance firms, and for our insurance consumers.

Mr. ROSS. Okay. And Director McRaith, I understand that you are going to be negotiating some covered agreements with three insurers coming up soon. Is that something that—what is the status of that right now? And what are your expectations with regard to the impact it is going to have on domestic reinsurers as opposed to foreign reinsurers?

Mr. MCRAITH. The covered agreement is a serious endeavor. We have never done it before. We are sorting through internal process questions. Before we negotiate, during any negotiations, we will work actively with this committee to ensure that you are informed. The outcome of any agreement is very difficult to predict. Of course, we haven't even commenced negotiations. But I can tell you the only way in which we pursue and reach an agreement is if it serves the best interests of our country, including U.S. reinsurers who might be operating within the European Union.

Mr. ROSS. I appreciate that. And I appreciate the further guidance on that. Finally, Commissioner McCarty, is there anything that we can do—I understand, look, that we have probably the best system of insurance regulation in the world. And nobody else has our particular models that have been provided for under the McCarran-Ferguson Act that allow each State to do that. I assume there are always some problems and some issues, and that each State addresses them. Is there anything that you would recommend for us as Members of Congress, that we should be ready to be preemptive on if necessary in the event of anything you see coming down the pike with regard to IAIS capital standards?

Mr. MCCARTY. Actually, I have a lot of confidence in the team that we have on the field. We are kind of new at this. The U.S.

system is complicated, and a lot different than the rest of the world. And it is very difficult for the IMF and others to really understand the complexity of the U.S. system and the different parts that are involved. I am confident to say that I think we do have a powerful voice. Director McRaith sits as the Chair of the technical committee, and has made very significant progress in allowing a different path away from the market consistent valuation to include a GAAP plus approach. So the American voice is being heard. And I think if we continue to work together—I think it is not clear all the time just how much work is being done behind the scenes at the senior level as well as at the staff level of trying to work our way through to come up with comprehensive, cohesive U.S. positions. And I think if we continue those efforts and continue to report back to you, with your oversight, we will hopefully devise a system that complements the U.S. regulatory system and does not challenge the system we have in place that has worked so well for our consumers.

Mr. ROSS. Thank you very much, Commissioner. I yield back.

Chairman LUETKEMEYER. I don't want to keep picking on Mr. McCarty here, but it seems like he always gets the last question. And so, you need to keep your answers concise. But since we don't have very many people here, we are going to allow the questions to go a little longer. With that, I yield to the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the witnesses as well. Mr. McCarty, because you weren't quite finished, I will yield some of my time for you to continue with your response, if you would like. Because my question that I was going to lead with was one that deals with the international developments at the FSB as well as the IAIS and how they work in conjunction with the State and Federal levels. So you can you continue, please?

Mr. MCCARTY. Just to be clear, you are talking about the Financial Stability Board, the FSB?

Mr. GREEN. Yes.

Mr. MCCARTY. Yes. We do have some concerns from State regulators' perspective about the FSB since the FSB is really comprised of largely people who have a bank-centric view. We do have our U.S. representatives, and we feel very comfortable that they represent the U.S. position. But as the U.S. regulators of insurance, we feel that we should play a more prominent role and have a voice on the FSB.

Our concern is that oftentimes the principals at the FSB view the insurance through the prism of banking. And we know there is a very different business model for banking and insurance, and that it would be very problematic for the insurance industry, for us to have superimposed on us a regulatory regime that is capital-based, capital and bank-centric. And so having a voice in that arena would be very helpful.

Mr. GREEN. Let's talk about AIG for just a moment. I am sure there has been a substantial amount of discussion. But as you know, we bailed AIG out to the tune of about \$80 billion. And I am also proud to announce that the government has been successful in collecting, which is a good thing. But with reference to AIG and the means by which we found ourselves having to bail AIG out,

are there State or Federal laws or regulations that would prevent AIG from doing this again?

Mr. McCARTY. I don't think there has ever been any more of a studied case study in the history of the financial sectors than has been done on AIG. I have had the opportunity to discuss this with my colleagues across the different financial sectors. And it is important to understand that the failure of AIG was not a failure of the State regulatory system; it was a failure of the regulatory system because of the financial services division that was left largely unsupervised. It was under the Office of Thrift Supervision. They had a light touch, if you will, in terms of consolidated supervision. That, of course, has been remedied under Dodd-Frank. Those responsibilities have been moved to the Federal Reserve. I feel fairly confident that the Federal Reserve will not have a light touch when it comes to supervising from a consolidated basis the organization within the structure of an AIG or any other company under its supervision.

So I do think appropriate steps have been taken. And I think that again, this is going to require—the Federal Reserve and the States have been working together for years. We really regulate very different aspects of a company. We look more at the insurance entity from the inside, and they look more at the group. I think, though, that with cooperation, collaboration, continuing to work with our colleagues, we will be able to provide a structure to prevent a future AIG. But I would like to emphasize once again that the way to address this is to identify risk, systemic risk in particular, and figure out ways of minimizing that so it doesn't pose a risk to the greater economy.

Mr. GREEN. On that point, if we had been in a position such that there was a requirement to view the capital standards of the group at the group level, would we have been able to spot the issues that caused AIG to collapse before this happened?

Mr. McCARTY. No. I have been in conversation with a number of people on this subject, and from my understanding, there is no amount of higher loss absorbency that you could have put in or contemplated that would have prevented the meltdown of AIG. It was not a matter of insufficient capital or an overlay of capital; it was a matter of supervision, and quality supervision, and identifying the risk and finding out ways to deleverage that risk.

Mr. GREEN. With my 15 seconds that are left, would anyone else care to comment on that?

Mr. VAN DER WEIDE. I will just comment briefly that I think Commissioner McCarty has identified correctly the main tool that is now available to deal with an AIG problem going forward, and that is the FSOC has the ability to designate any systemically important non-bank financial firm and to hand them to the Federal Reserve to provide consolidated supervision and regulation of the entire group. And I think that is probably the most targeted tool that Congress has now developed to prevent a recurrence of an AIG-style event.

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

Mr. WESTMORELAND [presiding]. The gentleman yields back. Mr. Pearce is recognized for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman. I appreciate the testimony that you have each brought here. Mr. McRaith, I think I might talk with you first. Tell me a little bit about the driving compulsion behind this regulation of the insurance market. Where is that coming from? It is my understanding that there is not a law that says we should do it. So what is it that is not functional about the system that says we need to start changing things?

Mr. MCRAITH. Congressman, are you asking about the international standards?

Mr. PEARCE. No, I am just asking why the underlying—what is the underlying value that says now we have to start regulating this market? Why did your position get created? Why is the Federal Government getting into the market? Is that a fair question, Mr. McCarty?

Mr. MCCARTY. I think there are specific things under Dodd-Frank that require the Federal Insurance Office, for instance, to identify gaps in insurance regulation in the U.S. marketplace, but also serve as a role representing the U.S. Government as appropriate at the IAIS. And I think that is the function that—

Mr. PEARCE. As a previous buyer of insurance for a business, I am alarmed when I see the Federal Government come in. So I am going to come back to you, Mr. McRaith. But does your agency, Mr. McCarty, see some reason for concern in what is coming out of the Federal Government?

Mr. MCCARTY. We obviously have concerns with a new partner in the arena, a new player in the arena, as to what role they will play and how much jurisdiction they will exercise. So we are very guarded in making sure that State regulation is protected. We will do so with an eye towards collaboration and cooperation. But we certainly want to protect what we think is appropriately the Congress' view, which was restated in Dodd-Frank: insurance regulation is by the States.

Mr. PEARCE. Mr. McRaith, you used to be a State regulator. Is that system not working? Is that the reason that you all are getting into it? Do you see your regulations being in addition to, on top of, or in place of State regulations?

Mr. MCRAITH. Congressman, we are not establishing regulations or imposing regulations. Our work internationally is to take the best ideas of our State system, and of the Federal Reserve, and to ensure that those ideas are reflected in the global standards that are set at the IAIS.

Mr. PEARCE. You don't think that eventually those standards will seep down into the market here?

Mr. MCRAITH. The only way those standards are implemented in the United States is either through the State system or through the Federal Reserve. International standards in the insurance sector have been around—the IAIS was founded in 1994. Standards have been around for 15, 20 years. They are not new.

Mr. PEARCE. Mr. Garrett's questions evidently eased into this area, and it didn't—the words I got back were not quite as clear-cut, that there was this great delineation between the markets that in fact they are tending towards being the same. So you are just saying that is not true, that we are going to keep ourselves nice and clear. Because take a look at it from our perspective in the

West. Back when we had local jurisdiction over local forests, we had operating Forest Service, we cut timber, the West thrived, we had jobs there. The Federal Government got into the business of the forests, and now 85 percent of the Forest Service is dead—85 percent of the forest market is dead, the companies are gone, jobs have disappeared in our district. And what I see is that any time the Federal Government starts playing around with anything regarding business, then it tends to choke that business off. So when I sit here and talk and listen to Mr. McCarty saying that we have cause for concern, and I hear you saying, oh, don't worry about it, I tend to believe I have cause for concern rather than the "don't worry" piece of it. And just know that we in the West struggle because there is so much public land, so much public, Federal Government involvement in the processes that they are choking off our economies one piece at a time, whether it is oil and gas, whether it is the Endangered Species Act, using a spotted owl to stop all the timber and later the Federal Government says, sorry we shouldn't have done that, it was never the problem, logging was not the problem. We are the ones who live at the end of that pipeline. So I am concerned about the direction that you are headed, the fact that we have created your spot. And I am concerned that it feels like it is tending towards concerns that Mr. McCarty might have and his association might have. Because I will be speaking for the people who buy insurance out there trying to just make a living day to day and hire a few people in the local area. That is what I don't want you involved in. Thanks, Mr. Chairman. I yield back.

Mr. WESTMORELAND. The gentleman yields back. I now recognize the gentleman from Pennsylvania, Mr. Rothfus.

Mr. ROTHFUS. Thank you, Mr. Chairman. And thank you, panel, for sticking with us. We have a lot going on this afternoon. I apologize if any of my questions might be redundant. I haven't had a chance to take a look at what other Members have asked. But Director McRaith, I wanted to start with you. When participating in international discussions on insurance regulation, and the United States is considering its position, how do you take into account the position of State regulators and the NAIC?

Mr. MCRAITH. We have extensive engagement and consultation with the State regulators on a constant basis. So we have regularly scheduled calls at least monthly. We have weekly, if not daily engagement at the staff or leadership level. Meetings that are ongoing will meet throughout the day or during the day of the meeting itself to ensure that we are all aware of and on the same page.

Mr. ROTHFUS. I want to move to Commissioner McCarty and get your feedback. Would you say that the Federal Insurance Office and the Feds seek your feedback and represent States appropriately?

Mr. MCCARTY. I would say that we have a very complex interaction with the Federal Reserve and the FIO. We have, as Mike has indicated, multi-level work streams working at the IAIS and the EU-U.S. dialogue on a number of issues. We do do a lot of interaction, and we certainly would welcome the opportunity to provide them with our history and background on solvency, prudential regulation in the United States. Mike, of course, is very familiar with that in his former position. We think that we are the

subject matter experts on this, and would certainly like to give deference to that, but they have their own respective roles in this regard, and they make their decisions accordingly.

Mr. ROTHFUS. Have you proposed or are you considering proposing ways to improve coordination and representation when international insurance discussions come up?

Mr. MCCARTY. Frankly, what started out as a relatively informal process has become a much more formalized process. And we continue to improve that. In advance of our IAIS meetings, we have a number of meetings in advance of that to look at the different decision points that are coming up, finding commonalities where we can agree, and figure out ways of strategically presenting those in the best interests of the United States.

Mr. ROTHFUS. I wonder if Deputy Director Van Der Weide and Director McRaith could maybe comment on coordination and ways to do things better? Are there any proposals on the table?

Mr. VAN DER WEIDE. In the past months we have increased extensively the amount of engagement that occurs amongst the FIO, the Federal Reserve, and the NAIC and the States on how we go about doing the international negotiations. It is quite important that to the maximum extent possible, we present a united American front in those negotiations with our European, Asian, and other international colleagues. And we are trying the best we can to do that. I think the consultations have been going quite well, and the collaboration has improved considerably as we have now entered into the more active phase of those negotiations. So I think the trend line is quite positive on increasing collaboration. And I am reasonably optimistic that we will be able to keep that increase going.

Mr. MCRAITH. Congressman, my only additional point is that when we started a few years ago, we started for the first time in the history of the country integrating the national and the State perspectives internationally. We have learned as we have moved forward. We have a very rigorous, aggressive engagement, coordination effort right now. We will, of course, continue to learn as we move forward. But we are in a good place, and we will only get better.

Mr. ROTHFUS. Director Van Der Weide, do you expect to finish our domestic standards before the IAIS sets its standards?

Mr. VAN DER WEIDE. I can't give you any definitive timeline on the Fed's development of its capital framework for the domestic insurance holding companies that we supervise. We are extensively engaged right now in outreach with U.S. insurers, and U.S. insurance supervisors to better understand how the U.S. State level risk-based capital regime works, and to measure the cost and benefits of various alternatives that we might take towards establishing those holding company capital requirements.

Mr. ROTHFUS. So as far as finishing our standards before the international standards are set, you can't make a commitment that say our standards are going to be first and then use that as a benchmark going in discussing the international ones?

Mr. VAN DER WEIDE. Yes. I can't give you a definitive time as to when we will complete our process. We are going to—

Mr. ROTHFUS. Would it be a good idea if we did that?

Mr. VAN DER WEIDE. I think it is important when we negotiate those international capital standards, that we do have a good vision, a shared vision among us as to the right outcomes. I think that is right. But at the same time, the pressure on us is we do want to get the domestic capital regime right. And it is a pretty complicated endeavor. We have a very diverse set of insurance firms that we need to devise a capital framework for, and we don't want to hastily produce a rule that doesn't work well for those firms. So it is important that we get that rule right. And we don't want to excessively accelerate that process.

But it is important, I think you are right, your instinct is right, that we need to, when we negotiate internationally at the IAIS, have a reasonably good shared vision of kind of the outcomes that we are driving towards.

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

Mr. WESTMORELAND. The gentleman yields back. I will recognize Mr. Green from Texas.

Mr. GREEN. Thank you, Mr. Chairman. I would like to borrow some of the language from my colleague. I wasn't available to hear and see all of the hearing, so this may be redundant as well. But I do appreciate the testimony that I have heard. We do have a good many things going on today, I assure you. But with reference to competitiveness not only nationally but internationally, I think that we all understand that we don't want American companies to be at a disadvantage. And specifically as it relates to the insurance market, there seems to be a notion that the regulators have a better understanding of banking than insurance law or insurance needs. What are some of the risks that are unique to the insurance industry? And if you have already answered, I beg your forgiveness, but I think it is good for me to hear this and for it to be repeated. Some things bear repeating.

Mr. VAN DER WEIDE. I will field that one. I think it is important, as the Federal Reserve devises its insurance supervision and regulatory framework for the 17 insurance holding companies that we supervise, that we make it reflect the insurance risks and the insurance business models of those firms. It is not appropriate for us to take a bank-centric model and apply it those firms. The Collins Amendment to the Dodd-Frank Act had required us to do that on the capital front, but thanks to congressional action in December, those shackles have been removed and we are now free to implement fully insurance-centric regulatory regime for those firms.

Insurance is different from banking in a significant number of ways. I will just mention a few of the key ways in which we think it is different. Insurers, particularly life insurers, tend to have longer-term liabilities than banking organizations. And they tend to engage in less liquidity transformation and maturity transformation. I think that militates in favor of a different regulatory regime. They also tend to have liabilities that are uncertain in amount. Bank liabilities tend to be of a fixed amount. The insurers' classic insurance liabilities are of an uncertain amount. The size of those liabilities will depend upon the eventuation of future mortality risks, longevity risks, morbidity risks, and natural catastrophe risks. That makes insurers quite different from a bank. And the last thing I will mention is on the asset side of the insurance

balance sheet. Many American insurers, again life insurers principally, have a separate account capacity. And that is a major asset class of many life insurers that simply isn't present on bank balance sheets. So there are a lot of ways in which insurers are different from banks. And we need to make sure that our regulatory and supervisory regime reflects those differences.

Mr. GREEN. And you are indicating that you believe you are in a position to do that at this time?

Mr. VAN DER WEIDE. Yes. We had been impeded by the Collins Amendment, but we feel like the change that Congress made to the Collins Amendment of the Dodd-Frank Act in December frees us up to devise a fully appropriate insurance-centric model for the 17 firms that are prominently engaged in insurance that we have.

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

Mr. WESTMORELAND. The gentleman yields back. And before I recognize Mr. Duffy, I want to thank all of you for your patience. I haven't seen one of you all make a face yet when these different Members are coming in. But this is something that is very important to all of us. And so, I do appreciate your patience.

But I did want to ask just a couple of questions. Mr. Van Der Weide, is the business philosophy of international insurance companies or European insurance companies any different than what you might say the philosophy of a domestic insurance carrier might be?

Mr. VAN DER WEIDE. The internationally active insurance companies certainly do expose themselves to additional risks that the purely domestic firms do not. They also have additional diversification opportunities that the purely domestic firms do not. And our work in the international regulatory space is to try to help make sure that we have a globally consistent supervision and capital framework for the foreign firms that operate in our markets.

Mr. WESTMORELAND. Let me ask it in a little bit different way. Is their philosophy about what should happen if there was a failure, who their allegiance might be to as far as what might happen to the assets of that company?

Mr. VAN DER WEIDE. I am not sure if I would draw a distinction between the—

Mr. WESTMORELAND. Okay. Let me ask you this. I know that our insurance companies are liable for the policyholder. That is who they protect. My understanding on the European model is that they protect the creditors, and not the policyholder, that the policyholder comes after the creditor. And in the United States, the policyholder is first. Is that your understanding?

Mr. VAN DER WEIDE. Yes. Different international insurance regulators have different objectives for their regimes. Part of the challenge that we will have collectively as we engage in those negotiations with the IAIS is to make sure that our vision of the appropriate way to do insurance regulation is put forward in a powerful way and is convincing. But one of the challenges, not just in insurance, but in any kind of international negotiation, is to deal with the different objectives that different regulators have around the world and try to meld those into a framework that from our perspective, works for America.

Mr. WESTMORELAND. So you are committed, or whomever is doing the negotiating is committed to making sure that the policyholders are put in first place.

Mr. VAN DER WEIDE. Yes. Absolutely. That will be a key goal of ours.

Mr. WESTMORELAND. Mr. McCarty, do you foresee, or do you or the State insurance commissioners have a fear that what they are negotiating is only for these international—or companies that participate internationally? When they write the rules for that, is it your fear that you may have to apply those same rules to all the insurance companies that you regulate? And how would you do that? Would you regulate different companies in different ways?

Mr. MCCARTY. You raise a very valid point. I think it is the concern that companies have, the large internationally active groups that may find them subject to higher capital standards or different enhanced policy measures. Their concern is that would put them at a disadvantage back home, where they are competing, whether it is homeowners, or auto, or business, liability insurance, medical malpractice, or you name it. So the concern they have is, they are certainly not going to put themselves at a disadvantage, and would encourage that State legislatures apply those standards uniformly, which could have consequences in the marketplace, both terms and pricing and product availability.

Mr. WESTMORELAND. Yes. Because you wouldn't want to treat one insurance company differently than you would treat another. And that is what I am afraid would actually happen. And we want to make sure that those policyholders, the people who pay the premiums, are the first to be protected.

Mr. MCCARTY. Can I circle back to something you mentioned earlier, which I think is the absolute key issue going into the discussions about an insurance capital standard, which is, what is the guiding principle? Is the guiding principle policyholder protection, which for the U.S. perspective is a ground-up, entity-based ring fencing? You ring fence those assets so they are available. The other concepts are the ongoing concern or creditor protection, very different policy measures and outcomes depending upon whether you are predicated on the policyholder protection, which we think is key.

Mr. WESTMORELAND. Thank you. The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy.

Mr. DUFFY. Thank you, Mr. Chairman. And I appreciate the panel being here today, and for not making any funny faces. That is a new standard that we have in the committee. But I do appreciate all of your appearances. I plan later today to introduce a bill that I have been working on for several months, the International Insurance Standards Transparency and Policyholder Protection Act. My staff has sent you guys all copies, or your teams copies of the legislation this morning. I can't imagine you have had a chance to review it thoroughly and comment on it today. I understand that you are all fast readers, but maybe not that fast. So I was hoping to get some of your initial thoughts on some of our key elements of the bill.

The bill establishes notification and reporting requirements for Federal regulators like yourselves to inform this committee and the

Senate Banking Committee when you intend to enter into negotiations and agree to international regulatory frameworks on behalf of the United States.

My bill also establishes a public notice and comment period so that all interested parties may make their voices known throughout the process. And my bill also creates objectives that regulators must meet during the negotiation process. These objectives promote the U.S. State-based system of insurance and our commitment to protecting policyholders. Hopefully, you will have a chance to review that after today's hearing and I can get your feedback on that. But in regard to Mr. McRaith and Mr. Van Der Weide, neither of you have an objection to keeping Congress informed on a regular, ongoing codified basis, do you? Mr. McRaith?

Mr. MCRAITH. We welcome the engagement with this committee, with members and staff of the committee, and also with members and staff of the Senate Banking Committee, and look forward to that engagement. We have had that over the last few years, and look forward to continuing that.

Mr. DUFFY. But engagement might be a little bit different. I am saying, hey, listen, we are going to systematically keep Congress informed. And so we know what information is going to flow from FIO and you know what information we expect to receive, as opposed to a looser arrangement where we are just going to have an engagement. You agree we should probably have some kind of system in place where we kind of have a certain timeline of getting information with regard to this process? Do any of you disagree with that?

Mr. MCRAITH. I am not sure—I haven't seen your bill, so I don't want to comment too specifically. But I don't know why something like that would be necessary when we are happy to visit with the committee and the staff on a regular basis and are happy to provide updates, engagement, and share thoughts and analysis as the work unfolds.

Mr. DUFFY. I guess sometimes systems are important in making sure certain requirements are met and certain expectations have a bright line so you know what we want and what we expect. And if you don't set up a process yourself on the flow of information, I think that we here can set up a process to say this is very clear for you what we want to know in regard to the process and how it unfolds. Mr. Van Der Weide, would you have an objection to a proposal such as this in regard to keeping Congress apprised?

Mr. VAN DER WEIDE. I think my views are very similar to those of Director McRaith. It is important for us to keep Congress very well-apprised on a frequent basis of our activities collectively as we negotiate international insurance regulatory standards. There is no question that is in the public interest. And we feel like we have been doing that. If there is additional consultation or information that you need from us, we are happy to do that. But I haven't seen your bill, and so I don't feel like I could comment upon increasing the systematicness of the relationship in any particular way.

Mr. DUFFY. Okay. And I appreciate that. But both of you have an interest in keeping Congress informed. I do appreciate that. Commissioner McCarty, my bill would require FIO and Treasury and the Federal Reserve to consult with the National Association

of Insurance Commissioners throughout the negotiation process. Do you believe that you have been kept up to speed thus far on the process, or the commissioners have?

Mr. MCCARTY. It has been an evolving process. As Director McRaith has articulated, I think we are in a good place now in terms of those discussions and negotiations. It wasn't a perfect process getting here, but I think we are in a good place. I have not had an opportunity to review the bill. The NAIC has a process for going through and commenting on legislation. But we certainly conceptually would agree with oversight. We are particularly concerned, sir, about the lack of transparency at the Financial Stability Board and the lack of transparency at the IAIS. And if there is a way for Congress to provide some more transparency in that process, that would be welcomed.

Mr. DUFFY. I know my time is almost up, or I am 15 seconds over, but you do believe that NAIC should be involved in the process and kept abreast of the process, correct?

Mr. MCCARTY. Absolutely.

Mr. DUFFY. Why is that important?

Mr. MCCARTY. First of all, we have been in this business for over 130 years. We have a remarkably strong record of providing solvency for our companies and providing a path for ensuring that policyholders get paid even in the resolution of a company. We have withstood many financial crises. And we have on-the-ground knowledge of insurance regulation, which everyone knows is very different than banking and securities. And so for us to have an equal partnership at the table is critical.

Mr. DUFFY. Thank you. And I would just ask that you guys share your thoughts with me. I look forward to partnering with you and working with all of you to make sure we get a process that works for everybody and for our committee. And so with that, Mr. Chairman, I yield back.

Mr. WESTMORELAND. The gentleman's time has expired. I want to thank all the witnesses for being here. I think that at least what I have taken away from this hearing, and the other information that we received that what happened at AIG was nothing but greed, and a lot of people were making a lot of money. And as usual, what the Federal Government did was way overreach to solve one very targeted problem that we could have fixed. But as people close to this Administration have said, you never let a crisis go by that you don't move the ball forward. And so what Dodd-Frank did, specifically with insurance companies in putting them under the SIFI rule and the other things, is cast a net so broad that you caught all the little fishes that you were not intending to catch. And so as a result, we have what we have.

And there are going to be all type of unintended consequences, as there is with anything that is complex as Dodd-Frank and all the many rules that it has put on different businesses, that we wonder why we only had a growth of .02 percent in our economy. It is a direct result of the overregulation that we have today. Our confidence is more into our State officials. I know Mr. McCarty was appointed. And I believe you may be the first appointed State tax commissioner from the State of Florida. Our insurance commis-

sioner is elected, accountable to the people. And Mr. Van Der Weide, I don't think you were elected by anybody, were you?

Mr. VAN DER WEIDE. No.

Mr. WESTMORELAND. Mr. McRaith, you are not elected by anybody, are you?

Mr. McRAITH. No, I am not.

Mr. WESTMORELAND. Most of our State insurance commissioners are elected, and they are held accountable to the people. And therefore, they put those people first. So I thank all of you for your testimony. Thank you for sticking around.

Mr. GREEN. Mr. Chairman?

Mr. WESTMORELAND. Without objection, I would like to submit the following statements for the record: the American Council of Life Insurers; the National Association of Professional Insurance Agents; the American Insurance Association; the American Academy of Actuaries; the Property Casualty Insurers Association of America and the National Association of Mutual Insurance Companies.

Mr. GREEN. Mr. Chairman, if I may. I beg you, Mr. Chairman, to give me about 10 seconds to—

Mr. WESTMORELAND. Okay, sure.

Mr. GREEN. —have one comment. I do believe that, Mr. Chairman—I agree with you that there are technical corrections that can be made to Dodd-Frank. But I want to make sure that I let people know that there is another opinion. And that while we can mend it, I am not one who believes we should end it. And I thank you for the time.

Mr. WESTMORELAND. I thank my friend. I am glad to hear you think there needs to be some adjustments. And I will help you with that in any way I can.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 1:18 p.m., the hearing was adjourned.]



# **A P P E N D I X**

April 29, 2015

Opening Statement of the Honorable Maxine Waters

Thank you, Mr. Chairman, and welcome witnesses.

I want to applaud the Federal Insurance Office for the work it has done thus far, coordinating and developing federal policy on prudential aspects of international insurance matters. I look forward to continued collaboration on those issues as well as on its work to examine the affordability and availability of insurance.

To prevent the possibility of a future collapse of insurance giants like AIG, Dodd-Frank instituted critical changes to the federal government's role in oversight and supervision of the insurance industry – but preserve states' authority to regulate and to resolve failed financial firms. While I believe that our state-based regulatory system has its strengths, I am encouraged that through Dodd-Frank reforms, we are filling important gaps and increasing collaboration that will only serve to further strengthen protections for consumers and policyholders. We continue to learn more about potential risks insurers can pose, not only to our national financial stability, but the entire global system.

In addition, Dodd-Frank created the Financial Stability Oversight Council, established to protect the stability of our financial system through identification and monitoring of systemic risks.

As part of this important work, the Council has designated certain companies as systemically significant. Now, the Federal Reserve will have supervision of these firms -- in addition to insurance holding companies that own federally chartered thrifts or banks.

Together, these reforms will help to ensure that we have vigorous oversight at both the federal and state level.

Finally, I want to reiterate that I remain open to working on resolving technical issues that may arise in the implementation of these reforms. Just last year, Congress responded to concerns that the Federal Reserve did not have flexibility to tailor its capital standards to the business of insurance. I am pleased that the Insurance Capital Standards Clarification Act of 2014 was signed into law, bolstered by robust Democratic support.

Thank you, Mr. Chairman. I look forward to continuing our conversation on these important issues.

I yield back.

Testimony of  
Kevin M. McCarty  
Commissioner  
Florida Office of Insurance Regulation  
On Behalf of the National Association of Insurance  
Commissioners

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

Regarding:  
The Impact of International Regulatory Standards on the  
Competitiveness of U.S. Insurers

April 29, 2015

**Introductory Remarks**

Chairman Luetkemeyer, Ranking Member Cleaver, and members of the Subcommittee, thank you for the invitation to testify today. My name is Kevin McCarty, and I am the Insurance Commissioner for the State of Florida. I am also a past President of the National Association of Insurance Commissioners (NAIC) and serve as the Chair of the NAIC's International Insurance Relations (G) Committee. On behalf of my fellow state insurance regulators, I appreciate the opportunity to offer our views and perspective on the international regulatory standards being proposed by the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS).

The U.S. insurance market is the largest and most competitive in the world, with \$1.8 trillion in premium volume and thousands of insurers writing policies. State insurance regulators supervise nearly a third of all global premium, and taken individually, U.S. states make up more than 24 of the world's 50 largest insurance markets. My home state of Florida, for example, is the 12<sup>th</sup> largest insurance jurisdiction worldwide by premium volume. To help put that in perspective, the Florida market for insurance is about the same size as Canada's market, about 50% larger than Australia's market, and nearly twice as large as Switzerland's market for insurance. As U.S. state insurance regulators who cooperate closely on a regular basis, we have long been committed to providing leadership on a wide range of global insurance issues and activities, with a focus on ensuring policyholder protections and maintaining stable and competitive insurance markets.

The NAIC and its members remain extensively engaged at the international level to ensure that our national state-based system has a prominent voice in the development and implementation of global insurance principles and standards. As we work with our international counterparts in developing the elements of a stronger international insurance regulatory framework, our primary objective continues to be to ensure that such standards are adaptable to our markets and benefit our consumers. We are committed to collaborating with our federal colleagues, where appropriate, and we are always ready to share our views with Congress on these important issues. We appreciate this subcommittee's continued focus on international developments at the FSB and IAIS and examination of the impact these activities could potentially have on U.S. consumers, companies, and markets.

**Global Capital Standards for Insurers Should be Compatible with the U.S. System**

State insurance regulators remain concerned about the development of international capital standards for the insurance industry as well as the process and speed with which the IAIS has been developing them. As you are aware, the IAIS is simultaneously developing capital proposals primarily to address systemically important firms, but also new requirements on internationally active groups that are not deemed too big to fail, including many firms based in the U.S. As part of the policy measures recommended for application to globally systemically important insurers (G-SIIs), the IAIS has moved rapidly, under specific direction and pressure from the FSB, to develop international standards for a basic group capital requirement (BCR) and additional higher loss absorbency (HLA) capital measures (capital buffers) that would be imposed on firms that are deemed too big to fail.

In addition, the IAIS is developing a global insurance capital standard (ICS) as part of a Common Framework for the Supervision of Internationally Active Insurance Groups

(ComFrame). U.S. state insurance regulators continue to have serious concerns about the aggressive timeline of developing a global capital standard given legal, regulatory, and accounting differences around the globe, but are fully engaged in the process to ensure that any development appropriately reflects the risk characteristics of the underlying business and does not undermine legal entity capital requirements in the U.S. The NAIC's objective is to ensure that the capital proposals developed at the IAIS are reasonable and compatible with our system. We must also ensure they don't inadvertently lead to unintended consequences such as limiting insurance products or stagnating growth in the insurance sector, including jobs and innovation. If tailored for our regulatory system, there is value in understanding the capital adequacy of insurance groups, particularly when part of a larger conglomerate or affiliated with other entities. But that value only exists if it supplements and wraps around our existing legal entity standards. We also remain concerned with the more volatile market valuation accounting approach favored by Europe as an international standard because it represents a short-term focus rather than a longer-term view and could have a negative impact on the U.S. market to the detriment of American insurance consumers.

In our view, taking a more homogenous regulatory approach that treats insurers more like banks may actually encourage new risk-taking in the insurance industry. Also, if the new standards are excessive or too inflexible, then they could increase costs on U.S. insurers and consumers and undermine the U.S. state-based insurance regulatory system, which is based on protecting policyholders and has a strong track record of effective solvency supervision and stable, competitive insurance markets. The IAIS must recognize that a system that has existing safeguards and controls to supervise the movement of capital within a group may take a different approach to capital adequacy at the group level than jurisdictions that do not have similar requirements. As we have cautioned in our previous testimony, the IAIS objectives on capital standards are not easily achievable and will require a significant commitment of resources over many years to ensure that they are compatible with the U.S. system of insurance regulation as well as with other jurisdictions around the world.

Of critical importance to the international discussions will be the Federal Reserve's implementation of the capital rules for savings and loan holding companies (SLHCs) and systemically important financial institutions (SIFIs) designated by the Financial Stability Oversight Council predominantly engaged in insurance operations. With the passage of the Insurance Capital Standards Clarification Act last December, the Federal Reserve gained flexibility to tailor its capital rules for these companies. We are hopeful that the Federal Reserve will utilize its flexibility to apply capital rules to these entities that are consistent with the insurance business model and our legal entity regulation and we are committed to assisting them in this important endeavor. We have had some constructive initial conversations with them and look forward to continued discussions in the future. But let me be clear, while the Federal Reserve has its responsibilities, we have our own. Most of the Internationally Active Insurance Groups (IAIGs) that will potentially be subject to the ICS are not SLHCs or SIFIs that are also regulated by the Federal Reserve. To that end, while we are committed to collaborating with our federal and foreign counterparts where we can, we still have a responsibility to the U.S. insurance sector. We will not implement any international standard that is inconsistent with our time-tested solvency regime that has provided long-standing protection to policyholders and ensured a competitive and stable U.S. insurance marketplace.

**Inclusive and Transparent Decision-Making Process is Critical to Effective Regulation**

Critical to the credibility of decision-making at the IAIS is an inclusive and transparent decision-making process. We continue to believe the IAIS's decision to limit direct stakeholder participation represents a step back for the openness and transparency necessary to give IAIS work credibility and legitimacy, particularly if and when legislative bodies are expected to consider IAIS proposals. The IAIS has new stakeholder and consultation procedures in place and state regulators participating at the IAIS will assess the effectiveness of these new procedures and continue to advocate for increased transparency, and will urge other U.S. IAIS members to support this worthy goal.

We remain equally concerned with the lack of transparency at the Financial Stability Board. While we appreciate the role of the Federal Reserve, Treasury, and the Securities and Exchange Commission as members of the FSB, state insurance regulators supervise 100% of the private insurance market in the United States and to date have had only limited access into FSB discussions directly relevant to our sector. This direct participation has only occurred as a representative of our international standard setting body, the IAIS, and not after requesting inclusion from our own U.S. FSB representatives. Particularly given the role of the FSB in designating three U.S. insurers as globally systemically important insurers, we find the lack of support for our inclusion at the FSB by our federal colleagues troubling and not reflective of the best interests of U.S. insurers and policyholders. In light of the significant influence the FSB has on the IAIS, it is important that the entire "Team USA" be involved in insurance related discussions at the FSB.

For our part, the NAIC has long-standing procedures and ongoing responsibilities to seek input from policyholders and other interested parties, and we will continue working on these issues in a transparent manner through our NAIC process. To that end, last year, the NAIC formed the ComFrame Development and Analysis (G) Working Group (CDAWG), which I chair, to provide ongoing review, and technical as well as expedited strategic input on ComFrame and the international group capital developments. In addition, the CDAWG has been exploring group capital concepts that would be appropriate for U.S. based internationally active insurance groups.

Most recently, the CDAWG helped review the first IAIS Consultation Draft on the ICS, which was issued in December 2014. State insurance regulators provided comprehensive feedback to the IAIS regarding the elements of the proposed ICS, such as valuation and potential methods for determining capital requirements. The NAIC is currently working through its open and public process to update its position statements on ComFrame and international capital developments with input from consumer and industry stakeholders. These documents serve to articulate the views of U.S. state insurance regulators toward the uses of capital within prudential regulation and help guide our ongoing work regarding IAIS capital proposals. As we work to affirm and update our positions, we welcome these additional perspectives to further enhance the focus of our regulatory priorities. We expect to finalize these positions shortly and will share them with the subcommittee.

**The EU-U.S. Insurance Project Has Potential to Enhance Transatlantic Insurance Markets**

Building on a regular series of transatlantic insurance dialogues over the past decade, the EU-U.S. Insurance Project was initiated in 2012 by the FIO, the NAIC, the European Commission,

and the European Insurance and Occupational Pensions Authority. The original purpose of the project was to develop a deeper understanding of our different approaches to solvency oversight and explore ways to increase cooperation and collaboration where possible.

In 2012, the U.S. and EU teams issued a joint report along with a Way Forward document outlining common objectives and initiatives to be pursued over the next five years on various aspects of transatlantic group supervision such as ways to enhance the effectiveness of international supervisory colleges. In 2013, a joint EU-U.S. public forum hosted by the NAIC was convened on international insurance group supervision and supervisory colleges. The Way Forward initiative was updated in July of 2014, based on recent developments and progress achieved to advance mutual understanding and recognition. Another public forum on group supervision was held in October 2014 in conjunction with the IAIS Annual General Meeting in Amsterdam.

While there has been progress toward achieving a better mutual understanding of the regulatory tools and approaches used by the U.S. and Europe, there are still many questions going forward about how the EU will treat U.S. firms under its new Solvency II oversight regime when it becomes effective in 2016.

One of the core issues of discussion between U.S. and European regulators has been Europe's call for a reduction in our reinsurance collateral requirements. State regulators had historically required foreign reinsurers to hold 100% collateral onshore in the U.S. for any U.S. business. In response to the concern of our foreign counterparts, state insurance regulators have worked to develop a new model law and processes by which collateral can be reduced in a consistent manner commensurate with the financial strength of the reinsurer and the nature of the regulatory regime that oversees it. Currently 26 states have adopted the revisions to the credit for reinsurance models. Insurers domiciled in these 26 states write more than 60% of the primary insurance premium in the U.S. We are also currently aware of 11 additional states that are actively considering the model or similar proposals which would raise this market share to approximately 93%.

In spite of extensive state responsiveness and action, the Treasury Department has expressed an interest in initiating discussions with the European Union on a preemptive "covered agreement" regarding reinsurance collateral. The Treasury and the United States Trade Representative (USTR) were given authority under the Dodd Frank Act to sign an agreement with a foreign government that could preempt state laws, such as collateral requirements, under certain circumstances. The NAIC is not convinced that a preemptive covered agreement, relating only to the issue of reinsurance collateral, is necessary given our clear and continuing progress on this issue. While we will continue to engage Treasury and USTR on this issue, and would expect to be directly included in any deliberations should they move forward, we believe preemption of state law by federal agencies should always be a last resort.

### **Conclusion**

U.S. insurance regulators have a strong track record of effective collaboration and supervision, and the NAIC is committed to coordinating with our federal and international counterparts to help ensure open, competitive, and stable markets around the world. It is critical that we 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. Consistency in regulation globally is important, but preserving regulatory independence and diversity of thought can also serve as a buffer against contagion or one-size-fits all behaviors by financial firms that can result from one-size-fits-all regulatory approaches. Congress has delegated insurance regulatory authority to the states so we have a continuing obligation to engage internationally in those areas that impact the U.S. state-based system, companies, and consumers. U.S. state insurance regulation 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. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.

**EMBARGOED FOR DELIVERY**

**Testimony of Michael McRaith**  
**Director of the Federal Insurance Office, U.S. Department of the Treasury**  
**Hearing on the Impact of International Regulatory Standards on**  
**the Competitiveness of U.S. Insurers**  
**House Financial Services Subcommittee on Housing and Insurance**  
**April 29, 2015**

Chairman Luetkemeyer, Ranking Member Cleaver, Members of the Subcommittee, thank you for inviting me to testify today on the impact of international regulatory standards on the competitiveness of U.S. insurers.

The Federal Insurance Office (FIO) publishes an annual report to address the state of the insurance industry and related regulatory or macroeconomic developments. FIO's 2014 Annual Report included sections describing (1) a financial overview of the U.S. insurance industry, (2) developments and issues with respect to consumer protection and access to insurance, (3) regulatory developments, and (4) international developments.<sup>1</sup>

Among the highlights, the 2014 Annual Report analyzed data demonstrating that, in the aggregate, insurers operating in the United States continue to show resilience in the aftermath of the financial crisis, including record levels of capital and surplus. At year-end 2013, the life and health sector (L/H) reported \$335 billion in capital and surplus, and the property and casualty sector (P/C) reported approximately \$665 billion in capital and surplus.

Aggregate net written premiums in the L/H sector declined slightly from the record level set in 2012, largely as a result of lower annuity sales, whereas P/C sector net written premiums grew modestly in 2013.

2013 bottom line numbers were encouraging. Record net income levels were achieved in 2013 for both the L/H and P/C sectors. The protracted low interest rate environment, however, has been a drag on net income, particularly for life insurers. To partially mitigate declining investment yields, insurers, as a sector, have marginally increased asset allocations towards lower rated and less liquid assets with longer durations, indicating increased portfolio risks. The L/H sector benefitted from the performance of separate accounts, and recorded net income of \$44 billion for 2013, as compared to the previous record high of \$37 billion set in 2006. Lower catastrophe losses and favorable loss development contributed to higher net income for the P/C sector, which reached a record \$72 billion; the previous high net income was \$66 billion, also set in 2006.

Per capita premium expenditures are a measure of private insurance density, or prevalence, throughout a national economy. On a per capita basis, from 2009-2014 insurance premiums for the combined L/H and P/C sectors have increased in the United States at an average rate of 1.6 percent, better than developed economies in Western Europe but less than growth rates in

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<sup>1</sup> FIO's 2014 Annual Report can be found at [http://www.treasury.gov/initiatives/fio/reports-and-  
notices/Documents/2014\\_Annual\\_Report.pdf](http://www.treasury.gov/initiatives/fio/reports-and-<br/>notices/Documents/2014_Annual_Report.pdf).

fast-developing Asian economies. For example, while France's per capita premium expenditure declined by 3.7 percent from 2009-2014, China's increased by 13.6 percent.

Aggregate premiums as a percentage of Gross Domestic Product (GDP) are a measure of private insurance penetration in a national economy. In 2005, aggregate L/H and P/C premiums amounted to 8.91 percent of U.S. GDP, and in 2013 total premiums amounted to 7.51 percent of gross domestic product, a decline of 15.7 percent. This indicates that the aggregate growth of U.S. premium volume did not maintain the pace of growth in GDP. In that same period, developing economies saw an increase in private insurance premium volume as a percentage of GDP, an indication that developing economies are pursuing private capital to support retirement security and the protection of personal and commercial assets.

To be sure, the U.S. insurance sector, including those firms that are internationally active, has an important role in the national economy. Indeed, in the United States, insurance is both local and global. Insurers compete in markets throughout the country, underwrite risk on a local and personal basis, and consumers have the benefit of local support from state regulators.

The insurance sector, both nationally and globally, is evolving dramatically, and we appreciate the opportunity to reflect with you upon where the sector is now and where it is going.

Recent federal developments are one aspect of change within the U.S. insurance sector. In January, Congress passed and President Obama signed the Terrorism Risk Insurance Program Reauthorization Act of 2015 (Reauthorization Act). The Reauthorization Act both renewed and reformed the Terrorism Risk Insurance Program (TRIP), and, in Title II, reestablished the National Association of Registered Agents and Brokers (NARAB). With respect to TRIP, the program includes sensible reforms that further reduce taxpayer exposure, increase private sector contributions, and support national security and continued economic growth. When fully operational, NARAB will serve as a solution to the long-standing multi-state licensing and administrative burden confronted by many insurance agents and brokers.

Much attention has been devoted to developments in international standard-setting in the insurance sector. International insurance standard-setting activities are not new. In fact, the National Association of Insurance Commissioners (NAIC) was among the founding members of the International Association of Insurance Supervisors (IAIS) in 1994. Since that time, U.S. state insurance regulators have worked to set and meet international standards. Each of the 56 independent members of the NAIC (50 states, the District of Columbia and five territories) is also a member of the IAIS, and state regulators have more votes in the IAIS plenary session (15) than any other jurisdiction.

More recently, since it became a full member in 2012, and consistent with its statutory role, FIO has represented the United States on prudential aspects of international insurance matters, including representing the United States at the IAIS.

In October 2014, the Board of Governors of the Federal Reserve System (Federal Reserve) became a full member of the IAIS. With the combined participation of state insurance

regulators, the Federal Reserve and FIO, all aspects of the unique U.S. insurance oversight system are actively engaged at the IAIS.

When dealing with the IAIS standard-setting work, FIO, the Federal Reserve and state insurance regulators work together extensively and regularly coordinate. As the U.S. participants of IAIS, the leadership and staff of all three groups are in close and meaningful engagement through frequent calls and meetings. Our collaboration is a testament to the shared objectives of the agencies involved.

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

Supporting much of this local and global activity is the global reinsurance industry – a market with many important participants based outside the United States. In fact, based on gross premiums ceded, more than 90 percent of the unaffiliated reinsurance of U.S. property and casualty insurers is placed with a non-U.S. reinsurer or a U.S. reinsurer with a non-U.S. holding company parent.

In recognition of both the U.S. market and the U.S. system of insurance supervision, FIO's international work is guided by three priorities: (1) to promote and enhance a competitive U.S. insurance market through effective, efficient supervision; (2) to establish prudentially sound, equal-footing for U.S.-based insurers to operate successfully around the world; and (3) to safeguard financial stability.

At the same time that we support diverse and competitive U.S. insurance markets, FIO strongly supports continued growth of the increasingly international insurance market and the prudential standards that promote consistent and rigorous oversight across jurisdictions.

In the last ten years, the pace of globalization in insurance markets has increased exponentially and is expected to continue to grow in the coming years. Insurers based in the United States are pursuing opportunities for organic growth in new markets. Aon Benfield's 2014 Country Opportunity Index, which identifies the world's most promising P/C markets, listed five Asian markets among its top ten, in addition to three from Africa and two from South America. Even a cursory review of the demographics in Brazil, China, India, Indonesia and South Korea demonstrates this point.

In fact, U.S.-based insurers are extending operations around the world, and a growing number expect in the coming years to generate 40 percent or more of revenue from outside the United

States. In addition, in 2014, well-known U.S. insurers that are subsidiaries of non-U.S. holding companies accounted for more than 13 percent of aggregate L/H and P/C premium volume.

Private market premium volume growth shows that insurers are committed to international growth. Measuring global market share by aggregate premium volume, from 2008 to 2013, the United States' share of the world market declined from 29 percent to 27 percent despite an increase in real dollars of more than \$32 billion. For the same period, China's share increased in real dollars by more than \$137 billion and as a percentage of the global market from 3 percent to 6 percent. As reported in FIO's 2014 Annual Report, South Korea, Brazil and South Africa experienced similar proportional increases.

These numbers reiterate the message that developing markets present important growth opportunities for U.S.-based firms and that growth will continue at an increasing rate in the years to come. Growing economies around the world seek private sector solutions through life insurance products for retirement security and through property and casualty insurers for private asset accumulation and protection.

Due to global economic growth, many jurisdictions – both developing and well-established markets – are modernizing insurance supervisory regimes. For example, in North America, both Mexico and Canada have undertaken sweeping insurance regulatory reforms, just as have Australia, China and South Africa.

Global supervisors welcome the influx of private capital from insurers domiciled in the United States, and elsewhere, and are increasingly desirous of a common language and common standards by which to understand how a globally active insurer manages risk. These supervisors want to know how consumers subject to that supervisor's protection fit into the insurer's broader risk management approach. This is fundamentally a question of consumer protection: how are consumers around the world protected when insurers operate globally?

As the insurance sector evolves globally, the United States will continue to contribute constructively in support of international standards that, when implemented, will benefit U.S. consumers, U.S. insurers and global financial stability. Working together, U.S. participants of the IAIS are already leading developments in international standard-setting activities. Absent the participation and leadership of U.S. participants, international standard-setting activities would continue without reflecting the unique features of the U.S. market and regulatory structure.

#### IAIS Capital Standard Development

International coordination can be difficult even under the best of circumstances. However, through the IAIS, our engagement, communication and coordination with other countries has been collaborative and productive. This is not to say that we agree with every IAIS member on all substantive, technical or procedural issues. Insurance supervisors from around the world come together through the IAIS to learn, to analyze, to develop and to understand best practices for insurance supervision. Each country or region brings its unique perspective and predisposition to the conversation, and all have the opportunity to learn. The challenge is to find a path to consensus, around practical and achievable objectives.

The development of capital standards at the IAIS dates back to at least 2009, with the commencement of a common framework for the supervision of internationally active insurance groups, or ComFrame. More broadly, and in response to the global financial crisis, G-20 Leaders at recent Summits asked the Financial Stability Board (FSB) to develop a policy framework to address the systemic and moral hazard risks associated with systemically important financial institutions. In response, the FSB, which coordinates G-20 financial regulatory initiatives, developed a framework and called on the relevant international standard-setting bodies to, among other things, develop methodologies for identifying globally systemically important financial institutions (G-SIFIs) in each financial services industry.

In July 2013, the FSB called upon the IAIS to develop a backstop capital requirement (now known as Basic Capital Requirement, or BCR) by 2014 for globally systemically important insurers (GSIs) and to develop in 2015 an approach to higher loss absorbency (HLA) for GSIs in 2015. These policy measures conform with the G-20 endorsed FSB framework for systemically important financial institutions, which calls for higher loss absorbency for all G-SIFIs. The FSB called upon the IAIS to continue development of ComFrame, and to include in ComFrame a quantitative insurance capital standard. This comprehensive work plan and the related deliverables (including ComFrame, BCR and HLA) have been welcomed by G-20 Leaders.

At its 2014 Annual Meeting in October, after more than 12 months of data analysis, testing and consultation, the IAIS adopted an approach to the BCR. The BCR is the first global group capital standard for the insurance sector and provides a simplistic method to measure capital within an insurance group across jurisdictions. The BCR will serve as the starting point for both the HLA and the insurance capital standard (ICS), the latter of which will likely supersede the BCR as the future basis for HLA for GSIs.

Development of HLA for the insurance sector presents a significant technical challenge. Insurers, the products sold by insurers, and existing jurisdictional capital requirements, vary greatly around the world. Following months of intense analysis and drafting, the IAIS consultation paper on HLA will be released in June for a period of sixty days.

With respect to the ICS, the IAIS released a consultation paper in December and written comments were received from stakeholders for more than sixty days. The consultation paper was highly technical, and generated 1500 pages of comments from stakeholders.

As publicly described in March 2015, IAIS members agreed on the “ultimate goal” of the ICS which provides a focal point, a guiding light, for the technical work that is underway. IAIS members agreed:

The ultimate goal of a single ICS will include a common methodology by which on ICS achieves comparable, i.e. substantially the same, outcomes across jurisdictions. Ongoing work is intended to lead to improved convergence over time on the key elements of the

ICS toward the ultimate goal. Not prejudging the substance, the key elements include valuation, capital resources and capital requirements.<sup>2</sup>

As technical experts from the United States and around the world sort through the many complexities of the key elements, the “ultimate goal” provides the boundaries to shape and influence those conversations and the day-to-day developments.

Given the enormous amount of technical work and the magnitude of the global differences, achieving this “ultimate goal” will not happen quickly. In the near term, building upon data, analysis and testing, progress will be made and convergence will improve. Importantly, work will proceed incrementally toward milestones that are realistic, achievable, and that are fact-driven and consensus-driven.

#### IAIS Organizational Reform

IAIS organizational reform has improved its financial independence, efficiency and transparency. Formerly, the IAIS charged stakeholders as much as \$20,400 annually in order to receive the designation of “observer” and thereby receive access to certain meetings, social events, and information. Through 2014, the IAIS received approximately 40 percent of funding from observers – primarily industry – thereby creating the appearance of a *quid pro quo* arrangement that detracted from the credibility of IAIS members and stakeholders. Due to the IAIS organizational reform, the financial dependence upon industry no longer exists.

At the same time, the IAIS has dramatically improved its engagement with and transparency to stakeholders. Perhaps most importantly, the IAIS no longer discriminates between stakeholders that pay the fee and those that do not. In addition, the following examples illustrate the improvements to the IAIS processes for stakeholder consultation:

- In 2014, stakeholder sessions for all IAIS workstreams amounted to less than 12 hours, but in 2015 IAIS stakeholder sessions for all IAIS already amount to more than 60 hours, with more sessions to be scheduled.
- The IAIS web site will contain information available to the public, not just to stakeholders who pay the annual fee.
- With the launch of a consultation paper, the IAIS will host explanatory meetings and calls so that stakeholders can learn about substance and structure of the document in advance of providing comments.
- After receiving comments on a consultation paper, the IAIS will publish the comments received, release a summary of comments, and offer a reply to the comments.

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<sup>2</sup> The ultimate goal of the ICS can be found in the IAIS’s March 2015 Newsletter and can be found at <http://iaisweb.org/index.cfm?event=getPage&persistId=47DFD3A5155D896B001B1CB99C644F78>.

- For the various work streams (e.g. capital, governance or market conduct), stakeholder contact lists are being developed so that those stakeholders can provide input to a consultation paper prior to the paper's release for comment.
- Release of a monthly newsletter to describe developments in the preceding month and events scheduled for the coming month.

While only a few IAIS workstreams were directly open to stakeholders before 2015, the new governance and transparency practices provide a uniform approach to openness and stakeholder engagement for all IAIS activities.

Finally, U.S. stakeholders have opportunities to meet and work with the U.S. participants. Working with state regulators and the Federal Reserve, FIO has coordinated opportunities for stakeholders, including industry and consumer advocates, to meet and present to all U.S. members of the IAIS at one time, thereby enabling the U.S. members to receive the views of a wide range of U.S. stakeholders in a U.S.-based forum.

#### EU and U.S. Insurance Project

The EU and the United States are both significant insurance markets. In terms of premium volume, despite the growing prominence of developing markets, the EU ranks first and the United States ranks second as consolidated markets. The EU and the United States are home to many of the world's most prominent global insurers – large multinational insurance groups that are pushing more aggressively into new markets around the world. The EU is also modernizing its approach to insurance regulation through Solvency II, a new EU-wide harmonized insurance regulatory regime.

With these facts in mind, FIO convened the insurance leadership of both jurisdictions at Treasury in January 2012. At this initial meeting, participants included FIO, state regulators, the European Commission, the European Insurance and Occupational Pension Authority, and the United Kingdom's Prudential Regulatory Authority. We call this the EU – U.S. Insurance Project (Project). State insurance regulators, including Commissioners Voss, McCarty and Considine, among others, have made invaluable contributions to the effort. Going forward, we welcome the participation of the Federal Reserve in the Project.

Thanks to the participants, the Project has been a demonstrably successful transatlantic collaboration. In September 2012, the Project released a report that identified similarities and differences between the regulatory approaches in the EU and United States, and, in December 2012, the Project released an initial *Way Forward*, which outlined common policy objectives and milestones through 2017. Following the EU's adoption of Solvency II in late 2013, and the December 2013 release of FIO's report entitled "*How To Modernize And Improve The System Of Insurance Regulation In The United States*," continued modernization by state regulators, and developments at the IAIS, the Project released a revised *Way Forward* in August 2014 which

updated the common objectives and milestones.<sup>3</sup> Of course, as with all such international developments, implementation will occur in the United States only through federal and state authorities.

A central feature of the Project is work towards a potential covered agreement between the EU and the United States. A covered agreement is a unique statutory authority given to Treasury and the Office of the United States Trade Representative (USTR) to negotiate an agreement between the United States and one or more foreign jurisdictions that relates only to prudential insurance and reinsurance measures.

The 2014 *Way Forward* reiterates Treasury's support for USTR and FIO to pursue a covered agreement with respect to state-based reinsurance collateral requirements. The 2014 *Way Forward* also identifies both group supervision and confidentiality/professional secrecy as areas for which the possibility of a covered agreement should be explored.

Recently, the EU nations gave the European Commission the negotiating mandate to pursue an agreement with the United States that will "greatly facilitate trade in reinsurance and related activities" and "will enable us...to recognize each other's prudential rules and help supervisors exchange information."

Importantly, a covered agreement must provide tangible benefits for U.S. stakeholders. While the mechanics of a covered agreement process remain under development, and negotiations with the EU are not scheduled, FIO welcomes robust engagement with Congress, state regulators, and other stakeholders on the opportunity presented by a covered agreement.

#### Conclusion

Through effective collaboration at home and abroad, U.S. insurance authorities are positioned to provide U.S. leadership that complements the shared interest in a well-regulated insurance market that fosters competition, promotes financial stability, and protects consumers.

Importantly, it bears repeating that, in all of our work, both internationally and domestically, our priorities will remain in the best interests of U.S. consumers, U.S. insurers, the U.S. economy, and jobs for the American people.

We welcome the chance to work with this Committee and its excellent staff, and look forward to more discussions on these important topics.

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

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<sup>3</sup> FIO's report on *How to Modernize and Improve the System of Insurance Regulation in the United States* can be found at <http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/How%20to%20Modernize%20and%20Improve%20the%20System%20of%20Insurance%20Regulation%20in%20the%20United%20States.pdf>. The Project's revised *Way Forward* can be found at [http://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project/Documents/The%20Way%20Forward%20\(July%202014%20Revision\).pdf](http://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project/Documents/The%20Way%20Forward%20(July%202014%20Revision).pdf).

For release on delivery  
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Statement by  
Mark E. Van Der Weide  
Deputy Director  
Division of Banking Supervision and Regulation  
Board of Governors of the Federal Reserve System  
before the  
Subcommittee on Housing and Insurance  
of the  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C.  
April 29, 2015

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

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

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

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

After the passage of the Dodd-Frank Act, the Federal Reserve moved quickly to develop a supervisory framework that is appropriate for insurance holding companies that own depository institutions and promptly assigned supervisory teams to handle day-to-day supervision of those insurance holding companies. We also acted promptly to commence supervision of the three insurance holding companies designated by the FSOC for Federal Reserve supervision. While

building our supervisory regime for these firms, we have reached out to our colleagues in the state insurance departments. Our supervisory teams for insurance holding companies are a combination of experienced Federal Reserve staff as well as newly hired staff with insurance expertise. The Federal Reserve is investing significant time and effort into enhancing our understanding of the insurance industry and firms we supervise, and we are committed to tailoring our supervisory framework to the specific business lines, risk profiles, and systemic footprints of the insurance holding companies we oversee. Our supervisory efforts to date have focused on strengthening firms' risk identification, measurement, and management; internal controls; and corporate governance. Our principal supervisory objectives for insurance holding companies are protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions while mitigating any risks to financial stability.<sup>1</sup> We conduct our consolidated supervision efforts in a manner that is complementary to, and coordinated with, state insurance regulators, who continue their established oversight of insurance legal entities. We do not regulate the manner in which insurance is provided by these companies or the types of insurance that they provide. Those important aspects of the actual business of providing insurance are the province of the relevant state insurance supervisors.

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

Congress recently enacted the Insurance Capital Standards Clarification Act of 2014 (S. 2270), which amended the provision of the Dodd-Frank Act that had required the minimum

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

capital standards for banks be applied to any insurance holding company that controls an insured depository institution or is designated for Federal Reserve supervision by the FSOC. With this amendment to the Dodd-Frank Act, the Federal Reserve may now focus on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance. To that end, the Federal Reserve has been engaging extensively with insurance supervisors and regulated entities to increase our understanding of the regulatory capital regime that already applies to insurance companies under state laws and to solicit feedback on various approaches to the development of an appropriate consolidated group-wide capital regime for insurance holding companies that would be consistent with federal requirements. We are exercising great care as we approach this challenging mandate. We are committed to following formal rule making processes to develop our insurance capital framework, which will allow for an open public comment period on a concrete proposal. We will continue to engage with interested parties as we move forward.

**The Federal Reserve's Participation in the International Association of Insurance Supervisors (IAIS)**

Some of the insurance holding companies subject to Federal Reserve supervision are internationally active firms that compete with other global insurers to provide insurance products to businesses and consumers around the world. Our supervisory activities for these firms include collaborating with our regulatory counterparts internationally as well as domestically. As part of this role, in November 2013, the Federal Reserve joined our state insurance supervisory colleagues from the NAIC and the FIO as members of the International Association of Insurance Supervisors (IAIS). Accordingly, the Federal Reserve has been and will continue to be engaged

in the development of global standards for regulating and supervising internationally active insurers. Global standard setting is not new to the Federal Reserve, as we have for decades participated in standard setting for global banks through our membership in the Basel Committee on Banking Supervision. As a general proposition, we believe in the utility of having effective global standards for regulation and supervision of internationally active financial firms. When implemented consistently across jurisdictions, such standards help provide a level playing field for global financial institutions. Further, consistent global financial regulatory standards can help limit regulatory arbitrage and jurisdiction shopping and can promote financial stability. We recognize, of course, that international regulatory standards cannot be imposed on U.S. firms by an international body; rather, these standards apply in the United States only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures conducted here.

Since joining the IAIS in late 2013, the Federal Reserve has been an active participant in several key committees, working groups, and work streams. We currently hold a seat on the Financial Stability Committee and the Technical Committee of the IAIS. Throughout our first year and a half as a member of the organization, and consistent with our statutory mandate, the Federal Reserve has been particularly focused on the financial stability and consolidated supervision work of the IAIS. In these tasks, we have worked closely with our U.S. partners, including in particular the NAIC and its member supervisors.

**IAIS Strategic Priorities**

At the heart of the strategic priorities of the IAIS is the development of its Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).

Among other things, ComFrame includes the development of a global consolidated capital standard for large, complex international insurance companies. A group capital requirement for insurers with significant international operations is a new concept for U.S. insurance companies. State law includes capital requirements for insurance legal entities but does not include a group-wide or consolidated capital requirement for insurance groups. For the largest and most active global insurers, the Federal Reserve supports group-wide consolidated capital standards that are well tailored to insurance risks. We also strongly believe such standards must be deliberately developed through transparent processes and must be properly calibrated.

A second key focus of the IAIS involves the identification of global systemically important insurers (G-SIIs) and the design of an enhanced regulatory and supervisory framework for G-SIIs. In 2013, the Financial Stability Board, in consultation with the IAIS and using a methodology developed by the IAIS, designated a set of nine global insurance firms (including three U.S.-based insurers) as G-SIIs. In addition to developing enhanced supervision standards and resolution planning requirements for G-SIIs, the IAIS continues to refine its G-SII designation methodology and to work diligently to design loss absorbency requirements for G-SIIs.

Last year, the IAIS released the Basic Capital Requirement (BCR) for G-SIIs. It is the first international consolidated capital standard developed for the insurance industry. The IAIS developed the BCR to help provide a level playing field for the capital adequacy of global insurance firms with the largest systemic footprints. The IAIS intends to supplement the BCR with a Higher Loss Absorbency (HLA) capital standard for G-SIIs. The IAIS expects to release a consultation draft on HLA in June with an accompanying request for public comment.

In time, the IAIS expects that the BCR will be replaced by the more detailed and comprehensive Insurance Capital Standard (ICS), which is currently under development. Although the ICS likely will apply to a broader range of internationally active insurance groups, the IAIS expects that the ICS ultimately will also serve as the basis upon which HLA capital requirements for G-SIIs are applied by the relevant national jurisdictions. IAIS began work on the ICS in 2013, issued an initial consultative proposal on the ICS late last year, and will continue work on the ICS for at least the next few years. This work includes the active participation of many volunteer insurance companies, including U.S. insurance companies, through field testing of various approaches and options, as well as the participation of state insurance supervisors and others.

It is important to note that any standards adopted by the IAIS are not binding on the Federal Reserve, the FIO, state insurance regulators, or any U.S. insurance company. During the development of global standards for insurance firms by the IAIS, the Federal Reserve will work to ensure that the standards do not conflict with U.S. law and are appropriate for U.S. insurance markets and U.S. insurers. Moreover, the Federal Reserve would only adopt IAIS regulatory standards after following the well-established rulemaking protocols under U.S. law, which include a transparent process for proposal issuance, solicitation of public comments, and rule finalization.

**Cooperation and Coordination among U.S. Supervisors, Regulators, and the Industry**

The Federal Reserve, along with the FIO and the NAIC, continues to actively engage with U.S. insurance companies on the development of global regulatory standards for insurance firms. For instance, the Federal Reserve, the FIO, and the NAIC have hosted four separate

meetings with U.S. participants on the BCR and ICS since August of last year. These meetings were distinct and independent of two international sessions hosted by the IAIS. Moreover, in the coming months, the Federal Reserve, the FIO, and the NAIC are planning additional sessions with U.S. insurance firms, consumer groups, trade associations, and other interested parties. The Federal Reserve is committed to continuing this active level of dialogue and engagement and to continuing our work with the FIO and state and international insurance regulators to develop a set of standards for global insurance firms that is consistent across countries and appropriate for internationally active U.S. insurers.

Nothing in the IAIS work plan, including the group capital requirement, seeks to lessen the critical role of individual insurance legal entity supervision conducted by the U.S. states and foreign countries. Rather, group-wide consolidated supervision and consolidated capital requirements supplement this legal-entity approach with a perspective that considers the risks across the entire firm, including risks that emanate from non-insurance subsidiaries and entities within the group. The Federal Reserve is a consolidated holding company supervisor that focuses on identifying and evaluating risks, capital and liquidity adequacy, governance, and controls across its supervised organizations. U.S. insurers with a global footprint or global aspirations stand to benefit considerably from a level global regulatory framework that is strong but pragmatic. Reasonably consistent global insurance standards for internationally active insurers and international cooperation among global regulators provide the means to that end.

The Federal Reserve has acted on the international insurance stage in an engaged partnership with our colleagues from the FIO, the state insurance commissioners, and the NAIC.

Our multiparty dialogue, while respectful of each of our individual authorities, strives to develop a central “Team USA” position on the most critical matters of global insurance regulatory policy.

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



Statement for the Record  
 House Committee on Financial Services  
 Subcommittee on Housing and Insurance  
 Hearing titled "The Impact of International Regulatory Standards  
 on the Competitiveness of U.S. Insurers"

April 29, 2015

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the views of the life insurance industry regarding international insurance standards.

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums.

Both the Federal Reserve Board (Fed) and the International Association of Insurance Supervisors (IAIS) are developing insurance capital standards that are likely to have significant impacts on life insurance companies and the families who depend on them for financial and retirement security. Importantly, the IAIS has slowed its overly aggressive timeline for development of the Insurance Capital Standard (ICS), which can only be implemented through a state or federal rulemaking process.

Considered together, these two initiatives directly affect approximately 60% of the direct premiums of ACLI member companies. If these standards are bank-centric or inconsistent with capital standards developed by state insurance supervisors, they will disrupt the marketplace and undermine the ability of life insurers to provide long term, guaranteed retirement products to savers and retirees. To ensure the best possible outcome for policyholders, the Fed should fully implement the Insurance Capital Standards Clarification Act, develop an insurance capital standard that is appropriate for U.S. insurers and the insurance business model, and partner with the other U.S. representatives to the IAIS - Treasury's Federal Insurance Office (FIO) and state insurance supervisors - to ensure that any international insurance standards reflect the unique strengths of the U.S. system of insurance supervision.

### **Fed Should Fully Implement the Insurance Capital Standards Clarification Act**

The ACLI thanks Chairman Luetkemeyer, Ranking Member Cleaver, and the members of this committee for their support of the Insurance Capital Standards Clarification Act in the last Congress. As a result of the bipartisan leadership of this committee, as well as bill authors Representative Gary Miller, Representative Carolyn McCarthy, Senator Susan Collins, Senator Sherrod Brown, and

Senator Mike Johanns, both the House and Senate passed the Insurance Capital Standards Clarification Act by a unanimous vote in the last session, providing a clear statement that Congress supports appropriate capital standards for insurance companies. ACLI strongly supports full implementation of that law and urges continued congressional oversight to ensure that the intent of Congress and the competitiveness of the U.S. insurance industry is preserved. Congressional oversight of the development of a workable domestic capital standard for U.S. insurers will help support the goal of a well-capitalized and competitive insurance industry.

It is essential that policymakers correctly address insurance capital standards here in the U.S. first, so that our representatives to the IAIS, "Team USA", have a stronger, unified position in any international discussions. Common sense suggests that the U.S. should conduct its own process for the development of an insurance capital standard before agreeing to any international standards. The ACLI believes that it is in the best interests of the U.S. to focus on the domestic rulemaking first and ensure that the domestic process is as thoughtful, informed, and transparent as possible. The Fed process should include formal rulemaking with notice and public comment and ACLI is grateful that the Fed has indicated it will proceed in this way.

Any insurance capital standard must reflect the long-term nature of life insurers' investments and the need to match investments with the long-term duration of insurance liabilities. Bank standards that favor short-term assets simply do not work for the insurance company business model, in which commitments to insurance policyholders and annuity investors often last many decades. The ACLI believes that any consolidated capital standards developed by the Fed for insurance companies should be modeled on the state insurance risk-based capital system (RBC). RBC is a comprehensive capital framework specifically designed by insurance regulators to measure the unique risks of the insurance company business model.

### **The IAIS Timeline Must Accommodate the Fed's Capital Standards Rulemaking**

As the Fed implements the Insurance Capital Standards Clarification Act and develops an appropriate insurance capital standard here in the U.S, these processes should not be abbreviated or confused by a rushed IAIS timeline. The Fed rulemaking process should proceed normally and allow ample time for notice and public comment. The three U.S. representatives to the IAIS should not agree to anything at the IAIS that would interfere with a robust and thoughtful rulemaking process here in the U.S. In fact, the IAIS process would benefit from the work being conducted by the Fed and should adjust its timeline accordingly.

### **ACLI Supports the Team USA Approach**

ACLI commends the three U.S. representatives to the IAIS for the important partnership that they have established in the Team USA approach. Only by working together, meeting regularly, coordinating their efforts, and agreeing to common objectives, the Fed, FIO, and state insurance supervisors are best positioned to represent the U.S. and secure the best outcome for U.S. consumers and insurers. The Team USA concept constitutes an effort to speak with a strong, unified voice as part of any IAIS discussions and ACLI fully agrees with the wisdom of this approach.

Thank you for convening this important hearing and for your consideration of the views of ACLI and its member companies.



AMERICAN ACADEMY *of* ACTUARIES

*Objective. Independent. Effective.™*

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

Submitted for the Record

U.S. House Financial Services Subcommittee on Housing and Insurance Hearing  
Titled “The Impact of International Regulatory Standards  
on the Competitiveness of U.S. Insurers”  
April 29, 2015

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

On behalf of the American Academy of Actuaries’<sup>1</sup> Solvency Committee, I appreciate the opportunity to provide this written testimony for the Subcommittee on Housing and Insurance: “The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers.”

The International Association of Insurance Supervisors (IAIS) is developing group solvency and capital standards that could have a profound effect on internationally active insurance groups (IAIGs), including several U.S. insurers. As such, these international capital standards must be created in a careful, transparent, and meaningful manner. Failure to do so may undermine the ability of U.S. insurers to operate effectively and efficiently and could affect the financial stability of U.S. insurance industry.

To help guide both domestic and international policymakers through this process, the Academy’s Solvency Committee has created a comprehensive set of basic principles that we believe are essential to the development of effective group solvency and capital standards for insurers. Adhering to these principles will help policymakers and regulators alike create insurance capital standards that are appropriate for the insurance business model and do not harm U.S. insurance markets or consumers. These principles include:

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

1. A group solvency regime should be clear regarding its regulatory purpose and goals. For example, the purpose could be to protect policyholders, enhance financial stability, ensure a competitive marketplace, provide a level playing field, identify weakly capitalized companies, rank well-capitalized insurers, improve risk management practices and procedures, or some combination of the above. The regulatory purpose and goals will aid in the development of a standard itself, the associated regulatory actions, and priorities.
2. Any metrics, information, or other output of a group solvency standard should be useful to all relevant parties, including regulators, management, shareholders, and rating agencies.
3. A group solvency regime should promote responsible risk management in the regulated group and encourage risk-based regulation. For example, a solvency regime should recognize risk-mitigation activities, such as asset/liability matching, hedging, and reinsurance. Actuarial functions are critical in the risk management process and their role should be well defined, as it is in the U.S. reserving and solvency framework. Actuaries can and should identify where factor-based systems could miss emerging risks, set reasonable boundaries around estimates and modeling, and, as appropriate, render actuarial opinions.
4. Methods should recognize and take into consideration the local jurisdictional environments under which members of an insurer group operate, including the local regulatory regime, product market, and economic, legal, political, and tax conditions.
5. A group solvency standard should be compatible across accounting regimes, given the political uncertainties in achieving uniform standards.
6. A group solvency standard should minimize pro-cyclical volatility so as to avoid unintended consequences on insurance groups, insurance markets, and the broader financial markets.
7. A group solvency standard should present a realistic view of an insurance group's financial position and exposures to risk over an agreed-upon time frame.
8. All assumptions used in any capital or solvency model should be internally consistent.
9. It is more important to focus on the total asset requirement than the level of required reserves or capital on a separate basis. The focus should be on holding adequate total assets to meet obligations as they come due. Whether a jurisdictional standard requires the allocation of these assets to liabilities versus capital/surplus should be irrelevant to the overall solvency regime.
10. It must be demonstrated that the capital held is accessible, including in times of financial or economic stress, to the entity facing the risk for which the capital is required.

In addition to these principles, the Academy's Solvency Committee would like to provide a more detailed picture of the potential impacts of the IAIS's most recent proposed group solvency and capital standards. As the Subcommittee on Housing and Insurance continues its examination of

international insurance regulatory efforts, we hope you will bear in mind the Academy's Solvency Committee's response<sup>2</sup> to the IAIS on its *Risk-based Global Insurance Capital Standard* (ICS) public consultation document, dated Dec. 17, 2014, which we have summarized below.

#### *Comparability*

The IAIS's ICS should aim to be compatible across varying jurisdictional accounting regimes (i.e., between countries, states, and other international standards) without requiring a common valuation methodology for determining capital standards. Developing consistent valuation principles is likely to be very challenging and such principles are unnecessary to achieve a risk-based, globally comparable ICS. We note that the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have been unable to converge on accounting standards for insurance contracts, as developing a common balance sheet across jurisdictions is fraught with significant challenges. Furthermore, while we agree that it is important for regulators to be able to assess the risks faced by IAIGs, it is unclear whether a single capital ratio or a single risk factor for a similarly labeled product can result in true comparability across national boundaries or different insurance products. For example, the risk in auto insurance in a country with national health care and low incidence of civil litigation is different from the risk in auto insurance in a country without national health care and with high levels of claims filed.

#### *Minimize Pro-Cyclical Volatility*

The ICS should minimize pro-cyclical volatility so as to avoid unintended and harmful consequences on regulated insurance groups, insurance markets, and the broader financial markets. For example, the business models for U.S. insurers writing long-term business often do not rely on a market-adjusted approach. If such an approach inconsistently adjusts the value of assets and liabilities for changes in credit spreads then, to the extent that the cash flows offset, this would create artificial changes in the capital calculations that are not accurate and could distort and/or hide the real risks that an IAIG might face.

#### *ICS as a Minimum Threshold*

The ICS should be a minimum threshold for regulatory intervention. Functionally, a minimum threshold for intervention identifies groups that are financially troubled versus those that are financially sound. By definition, the "minimum threshold" for intervention will be a smaller amount of capital than any additional amount above the threshold that is needed to ensure that a company's capital is "prudent" or "strong." Implementing "target" capital levels above the minimum threshold will make comparisons between insurers and jurisdictions more difficult—particularly considering the differences among insurance markets, products, and lines of business globally—which works against the overarching goal of comparability.

<sup>2</sup> [http://actuary.org/files/Solvency\\_Committee\\_ICS\\_Consultation\\_Response\\_Final\\_020615\\_0.pdf](http://actuary.org/files/Solvency_Committee_ICS_Consultation_Response_Final_020615_0.pdf).

We note that the ICS does not need to serve as the sole capital requirement in every jurisdiction. Some jurisdictions could impose more stringent group capital requirements and others also may impose capital requirements on a legal entity basis. If it is designed appropriately as a regulatory minimum, the ICS need not override these other requirements. Instead, the ICS can serve as a group-level, globally comparable floor on capital. Local requirements that are more sensitive to the particular features of each jurisdiction can define the amount of any capital that should be held above the floor.

*Availability of Capital in Time of Stress*

It is important that the ICS is developed in a way that ensures assets are both accessible and available during a stressed situation. If capital is held in the location where the risk resides, regulators and policyholders can be assured that it will be accessible in a stressed situation. In contrast, if capital is in a different location, it may not be of use for addressing a stressed situation.<sup>3</sup> This can include situations such as funds subject to currency restrictions and funds held in one jurisdiction, where the regulator in that jurisdiction is unwilling or unable to allow funds to be used in other jurisdictions unless full payment to policyholders or creditors in his or her jurisdiction is assured.

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Thank you for this opportunity to provide our views on the impact of the proposed international regulatory standards on U.S. insurers. Actuaries have worked for many years with insurance and other financial sector policymakers to help develop prudent rules and regulations that address insurer solvency, including capital requirements. Actuarial expertise remains crucial to the creation of international and domestic insurance regulatory standards.

If you have any questions or would like to discuss these issues in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at 202.223.8196 or [sarper@actuary.org](mailto:sarper@actuary.org).

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<sup>3</sup> Note that this requires "location" to be defined in terms of regulatory authority, which may include both geographic and sector components.



American Insurance Association

**Statement by**

American Insurance Association

before the

Committee on Financial Services

United States House of Representatives

“The Impact of International Regulatory Standards  
on the Competitiveness of U.S. Insurers”

April 29, 2015

Chairman Luetkemeyer, Ranking Member Cleaver, and Members of the Subcommittee, the American Insurance Association (AIA) applauds your leadership in conducting today's hearing on the "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers." As you know, many stakeholders, including AIA, are actively engaged in the debate over international regulatory standards.

AIA is the leading U.S. property-casualty insurer trade association, representing approximately 325 member companies that write more than \$127 billion in premiums in the United States each year. AIA members offer all types of property-casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage, workers' compensation, homeowners insurance, medical malpractice, and product liability insurance. AIA and our member companies have a substantial interest in the development of capital standards, as this issue will influence the different local jurisdictions and regulatory approaches that our companies must navigate as they conduct business in the United States and in markets around the world. We appreciate the opportunity to share our view with the Subcommittee on this important topic.

While today's hearing is focused on international regulatory standards, it is important to recognize the ongoing domestic conversation regarding the implementation of Section 171 of the Dodd-Frank Act, known as the "Collins amendment." At the end of last year, Congress passed and the President signed the Insurance Capital Standards Clarification Act of 2014. This critical legislation clarified the Board of Governors of the Federal Reserve's (FRB) flexibility to tailor capital standards for insurance companies under its prudential supervision; those designated as Systemically Important Financial Institutions (SIFIs) and those companies that own a savings and loan association (thrift). The legislation reinforced the fundamental concept that a capital standard designed for banking organizations should not be applied to insurance companies, but should reflect the different risk profile, regulatory objective, and business model of those companies.

The FRB must now develop this differentiated insurance capital standard, and it is critical that the FRB get it right. To this end, AIA and other insurance industry stakeholders have engaged with the FRB to ensure the development of a capital standard that will work for the life and property-casualty sectors of the U.S. insurance industry, and utilize the risk-based capital foundation of the state-based insurance regulatory framework. Our urging of this approach to the FRB's capital rules is consistent with the Insurance Capital Standards Clarification Act of 2014 and the underlying objectives of the Dodd-Frank Act, which reinforced the primacy of the state-based insurance regulatory system while granting the FRB parallel, yet complementary, prudential supervisory authority over insurance SIFIs and thrifts.

Equally important, and consistent with the theme of today's hearing, securing a workable domestic capital standard is crucial to informing the process at the International Association of Insurance Supervisors (IAIS). A satisfactory outcome to the FRB's capital rule process will provide the basis for a consensus U.S. position among the FRB, state insurance regulators (represented by the National Association of Insurance Commissioners) and the Federal Insurance Office at the IAIS. As the ICS discussions evolve at the IAIS, such a consensus among the U.S. constituent members of the IAIS will

also provide the confidence needed to advocate for the international ICS to reflect and complement the capital approaches utilized by the group-wide supervisor for U.S.-based and non-U.S.-based insurance groups that are either internationally active (IAIGs) or have been determined to be global systemically important insurers (G-SIIs).

For the U.S. to be effective in ICS negotiations, all the U.S. members of the IAIS – collectively referred to as “Team USA” - must speak with a unified voice, meet regularly, coordinate their efforts, agree to common objectives, and collectively support a clear U.S. agenda that recognizes the statutory and regulatory framework applicable to U.S.-based IAIGs and G-SIIs. By doing so, Team USA will ensure that any eventual international ICS preserves a level playing field in the U.S. and around the world, allowing U.S.-based insurers to compete on equal terms. Strong, aligned leadership by Team USA is likely to yield the best outcomes not only for U.S. insurers and U.S. insurance customers, but ideally will develop and expand private insurance markets and competition everywhere. Congress and the Subcommittee in particular should continue its oversight role to ensure these favorable consequences.

We again thank the Subcommittee for holding this important hearing, and we look forward to working with the Subcommittee, regulators, and other stakeholders on the creation of the domestic capital standard for insurers, and at the IAIS on the international capital standard and other, related initiatives.

**Statement of PCI and NAMIC  
for the United States House of Representatives  
Committee on Financial Services  
Subcommittee on Housing and Insurance  
Hearing on “The Impact of International Regulatory Standards on the  
Competitiveness of U.S. Insurers”  
April 29, 2015**

The National Association of Mutual Insurance Companies (NAMIC) and the Property Casualty Insurers Association of America (PCI) thank you for the opportunity to comment on developments on international regulatory standards that could affect the competitiveness of U.S. insurers. Together we represent more than 2,000 insurance companies – roughly two-thirds of the property-casualty insurance market. These insurers and reinsurers represent a vast diversity of size and business model and provide insurance coverage critical to families and businesses throughout the U.S. and the world.

Our trade associations believe that the current U.S. state-based insurance regulatory system is robust and well-positioned to meet the needs of the nation’s insurance marketplace. It has helped produce the strongest, most competitive and largest insurance market in the world. And it has helped our sector improve the quality of life and the safety of the homes, highways and workplaces of all Americans. Finally, our state-based regulatory system is open and transparent to all interested parties, accountable, and able to respond effectively to evolving challenges.

We are submitting a statement to warn that our time-tested and effective system now faces unprecedented challenges, not only from international pressures to adopt global bank-like regulatory standards, but also from increased federal involvement in insurance as the Federal Reserve Board (Federal Reserve) and the Department of Treasury try to navigate their new responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the Insurance Capital Standards Clarification Act of 2014.

Having affirmed the primacy of state insurance regulation in both Acts, Congress must now increase its oversight regarding the unprecedented federal and international intrusion into state insurance regulation. Clarity regarding the intended outcomes of federal and international

involvement is necessary. Such action should include a clear statement of policy, applicable to federal and international negotiations, that reaffirms and defends the existing state-based system of regulation for all U.S. insurers and insurance groups, that encourages greater collaboration and unity among our U.S. agencies, that supports more transparency and accountability, and that ensures any new regulations are rare and only address documented gaps in protecting U.S. consumers rather than just a forced compromise between state insurance and federal banking or global standards. We appreciate the ongoing discussions of potential reforms in the Committee and look forward to assisting you in these efforts.

#### **The Current U.S. Insurance Regulatory System**

The U.S. has the largest and most diverse insurance market in the world, with a 150-year track record of comprehensive state solvency regulation protecting consumers. We are particularly proud of the role that our industry has played in helping to bring about safer homes, workplaces and highways—efforts that have saved countless lives and prevented the waste of huge amounts of resources. We are equally proud that our financial investment in America’s future through the municipal bonds that we buy helps build critical infrastructure that leads to a higher quality of life.

The U.S. insurance sector remained strong, stable and safe throughout the last several economic crises. (See Appendix 1). Despite a confluence in the last decade of record storms, market contractions and regulatory changes, property-casualty insurance has had no major recent insolvencies, has achieved record levels of policyholder surplus compared to premium to backstop our promises to policyholders (Appendix 2), and private sector insurance availability and competition is better than ever for consumers (Appendix 3) as demonstrated by the historic decline in the number of consumers having to turn to government residual markets. Compared to federally regulated banks, state regulated property-casualty insurers fared relatively well during the recent financial crisis (Appendix 4). They have suffered significantly fewer insolvencies, and the decline during the crisis in the stock valuations of publicly-held property-casualty insurers was not only far less than for banks but also less than for the New York Stock Exchange composite (Appendix 5). Property-casualty insurers also continue to be far

less leveraged than banks and our failures are not correlated with broader economic cycles (Appendices 6 and 7). The local focus of our state-based insurance regulatory system has been extremely supportive of responsive property-casualty insurance markets that address regional needs as well as the specific needs of local insurance customers.

Dodd-Frank created a Federal Insurance Office (FIO) to advise Congress and facilitate a unified voice on international insurance issues, and the Financial Stability Oversight Council (FSOC) to identify and reduce systemic risk. In addition, Congress abolished the Office of Thrift Supervision (OTS), in the process incidentally giving the Federal Reserve new authority over insurance holding companies with thrift subsidiaries. These new agencies and new federal responsibilities are still being sorted out but in some cases concerns are growing that the federal agencies are either veering from the intent of Congress or are being pressured to do so internationally.

In particular, although Congress preserved the Home Owners Loan Act' and a distinct holding company structure to govern savings and loan holding companies differentiating them from bank holding companies, the Federal Reserve has been continuously assessing how to fit systemically important insurance groups and insurance groups with depository institutions into its bank holding company regulatory system. In this effort they must address the conflicting pressures of banking regulation focused on macro-economic stability, holding company source of strength for depositors and federal deposit insurance fund protection contrasted with a completely different insurance business model that does not contribute to systemic risk and is focused on legal entity regulation for consumer protection.

#### **International Standard-Setting for Insurance**

The property-casualty industry has serious concerns about recent international standard-setting efforts that have morphed far beyond their original mission to develop best practices or principle-based standards. Instead, these bodies are increasingly trying to extend particular capital standards and accounting practices used by certain regions on a global basis that could significantly undermine the current U.S. insurance regulatory system. While a majority of the

members of our trade associations are domestic, all of the members have felt the impact of the international standards being imported to the U.S. Indeed, the movement toward more formulaic, one-size-fits-all prescriptive standards is accelerating and threatening both international and domestic-only insurers.

International decisions influence the content of regulation in the United States, and also influence the criteria by which the quality of U.S. regulation is assessed by organizations such as the International Monetary Fund (IMF). Standards initially being discussed only for systemically important or internationally active insurance groups are quickly bleeding into the more broadly applicable International Association of Insurance Supervisors (IAIS) International Insurance Core Principles (ICPs), in addition to creating enormous pressure on the state and federal regulators to conform.

U.S. regulators face intense pressure for global convergence from the Financial Stability Board (FSB), a largely opaque consortium primarily composed of international bank regulators, finance ministers and consolidated regulators that advocates one-size-fits-all global standards, as well as the IAIS, which has adopted in its Insurance Core Principles insurance standards based largely on Solvency II – a new top down, bank-like regulatory system adopted but not yet implemented by the European Union. U.S. state solvency regulation has been extremely successful, due not only to the structure of the regulation but also to its particular focus on protection of insurance consumers rather than investors and lenders.

Changing the existing regulatory paradigm to a centralized banking or Solvency II-like system, as the FSB and IAIS urge, would compromise our current system and lead to harmful consumer protection outcomes that Congress neither envisioned nor intended. Both higher consumer costs and less competition would very likely result.

#### **International Monetary Fund and the FSAP**

Following the 2008 financial crisis, all countries participating in the G20 agreed to IMF assessments of their financial sector laws and regulations every five years. These reviews are called the Financial Sector Assessment Program (FSAP) and were designed to create more global consistency in financial regulation. In 2010 the IMF first assessed the insurance laws and regulations in the U.S. to determine their “observance” of the IAIS’ ICs.

After the 2010 FSAP, several new model laws were put in place by the National Association of Insurance Commissioners (NAIC) in response to the recommendations from that report. These included several new requirements for holding companies, including:

- new enterprise risk management requirements;
- additional risk-based capital requirements;
- reduced foreign reinsurance collateral requirements;
- a new corporate governance disclosure; and
- new internal audit function requirements (See Appendix 8 for details).

All of these new models have or will likely become accreditation standards, meaning that each state must adopt them to maintain their accreditation by the NAIC. These new model laws have already changed the fabric of insurance regulation in the U.S.

Despite the NAIC’s efforts to develop model laws and movement at the state level to enact the model laws, the IMF returned in 2015 with lower scores for U.S. insurance regulation and more prescriptions for centralized regulation. Ironically, the IMF recognized the general effectiveness of the outcomes of the U.S. state-based regulatory system but criticized it for failing to conform more closely to the IAIS core principles. And unsurprisingly, the report supported a greater federal role in regulation. It is unclear how the new recommendations will be addressed by state regulators, the NAIC, and the Federal Reserve, but it is clear that in the current climate there will be more international pressure on our insurance regulatory system resulting in new requirements, new reporting, and increased costs – with little or no demonstrable benefit and a very real potential for harm.

**The International Association of Insurance Supervisors and the ICPs**

The IAIS used to be a forum for insurance regulators to discuss best practices, improve cooperation between regulators and inform developing countries that were creating an insurance regulatory system about the important issues to address. More recently IAIS members seeking to globalize their standards or centralize regulation have focused efforts on establishing Insurance Core Principles that are required standards for insurance regulation that members commit to adopt and are graded on their compliance. Beyond the Insurance Core Principles, the IAIS launched a new Common Framework for the Supervision of Internationally Active Insurance Groups (IAIGs), "ComFrame." Under current definitions, ComFrame would set a new regulatory scheme for the 50 largest international insurers, making up roughly a quarter of the U.S. property-casualty insurance market. ComFrame began as an attempt to promote cooperation and coordination among insurance supervisors. It has now become an effort to impose a series of quite specific new regulatory standards on large international insurers regardless of their status as systemically important. There is little doubt that once established, there will be pressure to apply the ComFrame standards more broadly.

It is important to note that the IAIS is not bound by due process and does not formally consider the costs of the changes it makes to international insurance standards relative to the presumed benefits of these changes. With each new or revised ICP or standard, the IAIS adds costs to international regulatory enforcement and compliance with little regard for the impact of these costs on governments, insurers, and consumers. At the IAIS, the U.S. is represented by the Treasury Department through the Federal Insurance Office, the Federal Reserve, and state insurance commissioners; however, these entities do not always speak with a unified voice and are greatly outnumbered by other member countries.

Most of the property-casualty insurance industry believes the chief mission of the IAIS ought to be to facilitate a stronger global insurance regulatory environment through cooperation and

coordination rather than attempting to create one-size-fits-all requirements for every country in the world. It is critical that our U.S. representatives cooperate and collaborate to advocate for the strengths of the U.S. system and oppose proposals that would not benefit U.S. consumers. Congress needs to restate this mission by clarifying the desired goals of the federal agencies in working with the state regulators and the U.S. insurance industry and discussing potential commitments to changes in regulation. More specifically, given concerns about the direction of the IAIS discussions on an insurance capital standard that would be applied to insurers that are not systemically important, just internationally active, Congress should direct U.S. representatives to forcefully advocate for the current state-based approach of risk-based capital requirements on a legal entity basis designed for policy holder protection, and not quantitative global capital standard for non-systemic insurance groups that focuses on protection of creditors, shareholders and others, beyond policyholders.

In addition, despite the introduction of bipartisan and bicameral Congressional resolutions and the opposition of state legislators, the IAIS has shut out interested parties from its working meetings. This action was opposed by our state regulators but they were not supported by our federal representatives. The resulting procedures are far less transparent than those of the states and NAIC. This episode serves as an unfortunate example of the lack of coordination between the members of the U.S. regulatory team participating internationally.

#### **Financial Stability Board**

Many decisions related to international financial services are being made by an arm of the G-20 known as the FSB. The FSB was established from a group of international central banks and finance ministers. It is housed in Basel, Switzerland, in the Bank for International Settlements, and has been chaired solely by various central banks. Unsurprisingly, the FSB tends to be bank-centric, and it was the FSB that tasked the IAIS with developing the capital standards for both Global Systemically Important Insurers as well as IAIGs. The U.S. is represented on the FSB by the Treasury Department, the Federal Reserve, and the Securities and Exchange Commission.

There are no U.S. state insurance regulators or lawmakers represented on the FSB and in fact there is only one FSB member focused primarily on insurance – the IAIS. The FSB decision-making process is largely opaque and there are few opportunities for communicating our members’ concerns, or the concerns of interested parties, to the U.S. representatives on the FSB. Consequently, there is ample reason to doubt that the FSB fully understands how its decisions affect insurance markets, or that the critical differences between banks and insurance are fully appreciated.

It is important to ensure that federal agencies representing the U.S. on the FSB and at the IAIS are advancing policy positions that represent the interests of U.S. insurance consumers, insurance markets, insurance regulators, and the U.S. economy in general. To that end, the U.S. should insist on an open and transparent policy development process, and the U.S. representatives who engage with international bodies should share a common agenda and a common message. That message should include a strong defense of the U.S. insurance market and existing state-based regulatory structure. It should also promote the interests of U.S. insurers and their policyholders. As in the case of U.S. involvement at the IAIS, the FSB represents an opportunity for better coordination between the members of the U.S. regulatory team participating internationally.

#### **The Development of an International Capital Standard**

**No Identification of Problem; No Flexibility in Key Principles** - On October 9, 2013, the IAIS announced that it would develop an Insurance Capital Standard (ICS) by the end of 2016 for all IAIGs, scheduled to be implemented beginning in 2019. The IAIS Executive Committee did not elaborate regarding the problem it was trying to solve or explain why the decisions were made, but insisted on a highly detailed, prescriptive formula for the ICS that would be applied to all countries; that all countries use the same valuation/balance sheet without regard to the costs and implications; and that the capital resources that companies use to meet the obligation be identical even when the capital instruments available to companies vary across countries.

**Comparability Not Obtainable** - Despite the goals of the IAIS to achieve a comparable ICS for all IAIGs around the globe, the application of the same capital standard to unique companies from very different regulatory environments with very different economic and political objectives will not produce comparable indicators of capital adequacy or solvency. Every country has a unique regulatory system with unique features that influence the solvency of the companies doing business in that regulatory environment. Similarly, every insurance group has unique characteristics that cannot be fully captured in a single one-size-fits-all formula.

**Exorbitant Costs; No Identification of Benefits** - In its zeal to achieve comparability, the IAIS will succeed only in generating unnecessary costs to governments and insurers. The costs to the U.S. will be significant. Our country will be required to make major changes to its supervisory, corporate law, and accounting systems to accommodate the new group capital requirements. Because the new standards will likely be derived from existing Solvency II standards, U.S. insurers will be placed at a competitive disadvantage relative to their foreign counterparts in the transition, and U.S. consumers will very likely bear the brunt of higher prices and fewer choices in the market.

**A Better Solution** - A workable global effort would not create competitive asymmetries between companies domiciled in different, but equally well-supervised, jurisdictions. What is needed is a flexible and dynamic principles-based and outcome-focused assessment that would recognize and improve understanding of diverse, successful approaches to solvency regulation. Under this approach, supervisors could achieve the desired goal of policyholder protection, and for systemically important insurers, the additional goal of insurer solvency, without the costs that would result from implementing new global systems in nearly every country in the world.

Unfortunately, the IAIS does not seem to be heading in this direction. Instead, the IAIS is developing more intensive capital requirements for non-systemically important IAIGs. This approach is based on the European Union model of requiring capital sufficient to prevent

failure -- that is to protect bondholders and investors, and not the U.S. standard, which is focused on policyholder protections.

Beyond that fundamental disconnect, there are also many more granular, troubling aspects to the approach of the IAIS. While it now recognizes that the ultimate, "fully comparable" ICS cannot be developed by 2019, it continues to push forward for development and implementation of an "interim" ICS by 2019. This may require changing accounting standards and favoring the local approach of one jurisdiction over another, creating further disproportionate costs between companies similarly situated. The potential market disruptions could be unintended, but very significant. Additionally, it appears that the IAIS is moving forward without a full assessment of the impact on consumers and insurance markets. Although the ICS to be proposed by the IAIS is not statutorily mandated and would have to be implemented by the states, the majority of the property-casualty industry is concerned that it would create pressure on the states to harmonize existing state standards to the ICS.

#### **One Voice – Team U.S.A.—On All Issues**

The U.S. regulatory team participating internationally needs to seek public input on the international policy issues it addresses internationally with the IMF, the FSB, the IAIS and any other standard-setters whose actions affect U.S. insurance laws and regulations. Drawing on information acquired through consultations with interested members of the public, this team must present a consistent and unified voice both publically and privately. The decisions about international positions should be made in an open, transparent forum that includes due process for all stakeholders impacted by the decisions. This includes both state regulators and state legislators who adopt state insurance laws. The U.S. positions should reflect the basic instruction from Congress to support the existing state-based insurance regulatory system in international negotiations.

In regard to the ICS, the U.S. should be pursuing an outcomes-based, flexible approach that recognizes the successful, state-based U.S. system. All of the U.S. representatives need to set aside concerns about what the FSB or the IAIS will or won't accept and agree on a clear and coherent position from which to negotiate internationally on insurance regulation. The various U.S. representatives engaged in these discussions have taken ad hoc steps to communicate with the industry and U.S. regulators on these capital policy positions, but there remain inconsistencies in the U.S. positions advanced internationally. A better, more systematic process is needed for this major issue and for many other standards under discussion internationally.

The critical importance of a Team USA that advocates positions consistent with effective state-based regulation is not limited to capital standards. The FSB and IAIS are working on a vast array of insurance regulatory topics including governance, remuneration, market conduct, resolution and recovery, and cyber standards. These have a tremendous potential to help or harm consumers and competitive markets, and our federal representatives should be fully engaged and cooperating with state insurance regulators in these projects. However, Congress can play a key role in helping to ensure that our federal representatives and state regulators are advocating consistent positions internationally on behalf of the U.S. insurance market and the regulatory system that protects its policyholders.

#### **Federal Reserve Insurance Capital Standards**

Until 2011, savings and loan holding companies were regulated by the OTS. In 2011, pursuant to the Dodd-Frank Act, the supervisory responsibilities of the OTS were transferred to the Federal Reserve, and savings and loan holding companies (SLHCs) were subjected to much greater risk supervision, liquidity and capital requirements, not just for the thrifts or banks but also the broader holding company. The Federal Reserve also has supervisory authority over entities designed by the FSOC as systemically important. Between its group-level regulation of insurers with thrifts or banks and insurers designated as systemically important, the Federal

Reserve has group-wide supervisory authority over more than 30 percent of the insurance industry, measured by premium volume. It should be noted that this supervision is in addition to, not in lieu of, all existing state regulation for these groups and their legal entities.

In the congressional hearings and public forums leading to the enactment of the Insurance Capital Standards Clarification Act of 2014, an oft-repeated theme was that regulators should avoid using a one-size fits all approach to setting capital rules for financial companies under its jurisdiction. This was most typically reflected in the view that insurance companies should not be regulated like banks and subject to rules designed for banking. We agree with this approach, but recommend that the analysis should not end with banking versus insurance when looking at a diverse range of insurance companies and business lines.

While the Federal Reserve has authority with respect to SLHCs and designated systemically important companies, it is important to note that there are distinct differences in these two categories of companies. SLHCs are subject to Federal Reserve jurisdiction as result of the presence of a depository institution and because Congress abolished the OTS, not because the companies pose any risk to the U.S. financial system. In addition, there are significant differences between property-casualty companies and life insurance companies necessitating very different capital structures and asset holdings. In fact, there are even substantial differences in the liabilities and asset needs facing different types of property-casualty companies (e.g., rate regulated homeowners' insurance versus environmental toxic tort liability).

Last year Congress passed with overwhelming support the Insurance Capital Standards Clarification Act of 2014. This legislation allowed the Federal Reserve to avoid imposing on insurers capital standards designed for bank holding companies. The Federal Reserve is now trying to ramp up its understanding of insurance to evaluate various domestic and international proposals regarding how it should supervise insurance holding companies under its jurisdiction. Numerous staff have spent considerable time and effort examining insurers, asking questions

not only about their depository institutions and potential risks to the federal deposit insurance fund, but about many unrelated insurance and commercial activities as well.

Some insurers have very small community banks and wonder whether Congress truly intended to create an additional layer of intensive Federal Reserve supervision of insurance for Main Street community operations. We fully respect the integrity of the Federal Reserve in carrying out its new responsibilities, but would suggest that additional clarity from Congress regarding its intent under the Dodd-Frank Act could be helpful.

As the Federal Reserve increases its understanding of insurance and balances its new responsibilities, to what extent does Congress intend for its involvement to be proportional to the risks that insurer-owned banks pose to the federal deposit insurance corporation or broader systemic stability? And to what extent should insurance activities be regulated by our primary functional regulator rather than by the Federal Reserve? In essence, what is the intent of Congress on state versus federal regulation of Main Street insurers?

We hope that to the extent that the Federal Reserve imposes supervisory requirements on insurance holding companies under its jurisdiction, including capital standards pursuant to the Dodd-Frank Act Collins Amendment and the Insurance Capital Standards Clarification Act, the Federal Reserve will focus on the holding company banking activities and rely to the extent possible on state regulatory standards for holding company insurance operations. In particular it is critical that the Federal Reserve not try to substitute a new capital measurement to replace state risk-based capital requirements and measurements. Rather, the Federal Reserve should recognize the state-based regulation of insurance operations and either exclude the insurance activities or aggregate the current state capital requirements of the insurance legal entities while focusing regulatory oversight on the non-insurance entities, the depository institution and, in the case of insurance systemically important financial institutions (SIFIs), the stability of the U.S. financial system. By doing so, the Federal Reserve would not need to try to replicate decades of sector-specific regulatory experience.

We would appreciate a dialogue that could be helpful to our regulators as well as our customers and look forward to participating as the regulators and Congress seek the right balance of oversight.

#### **FSOC Designation Process**

In passing the Dodd-Frank Act, Congress sought to ensure the stability of America's financial markets and reduce the exposure of taxpayers to costly bailouts. To accomplish this, the FSOC must follow the intent of Congress, which was to designate only those financial firms that pose true systemic risk. We are concerned that FSOC has not been sufficiently focused on identifying true systemic risk, and therefore strongly recommend that the Congress exercise robust and effective oversight of the FSOC designation process. This should include providing additional legislative direction to ensure that relevant provisions of Dodd-Frank are implemented in a manner consistent with the intent of Congress and that the FSOC is properly focused on identifying true systemic risk.

#### **Problems in the FSOC Nonbank Designation Process**

The Dodd-Frank Act set forth a list of factors the FSOC is to consider when determining whether a nonbank is systemically important. However, FSOC's designation decisions regarding insurance groups has not provided a meaningful analysis of these factors, focusing instead primarily on issues relating to the size of the company and on hypothetical and arguably implausible scenarios under which material financial stress at the company would pose systemic risk to the economy. By declining to address the statutory systemic risk factors, the FSOC's designation decisions have not clearly established a coherent rationale for the decision based on activities in which the firm engages. This does not foster confidence in the FSOC's decisions. It also leaves all companies in the dark about what activities the FSOC considers

systemically risky and thus provides no clear direction to companies on how to reduce systemic risk.

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

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

FSOC’s decisions to designate three insurers as systemically important are particularly disturbing given that they were reached over the strong and substantive objections of both FSOC’s Independent Member Having Insurance Expertise and the non-voting State Insurance

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

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

To its credit, FSOC recently adopted several new measures designed to address some concerns. The new measures include: improving engagement with companies being considered for designation; enhancing public transparency; and making the annual review process more meaningful. We applaud FSOC for taking these actions, which we view as improvements to the existing process. Nevertheless, they fall short of fully addressing the shortcomings we, the GAO, and others have identified. Most importantly, they do not bring the FSOC designation process fully into line with that envisioned by Congress and set forth in Dodd-Frank.

In considering how to exercise its oversight responsibilities over FSOC and improve the systemic risk designation process, we urge Congress and FSOC to keep in mind the following basic premises:

**Size Alone Does Not Create Systemic Risk.** FSOC must not create a new class of “too-big-to-fail” companies, blindly designating companies as systemically important simply because they are large without adequately analyzing other far more significant factors indicative of systemic risk. Few, if any, financial companies are systemically important solely because they are large. Engaging in highly risky activities, coupled with interconnectedness, leverage, concentration and other considerations set forth in Dodd-Frank, is what creates systemic risk. Unless FSOC fully considers and analyzes all of those factors, it cannot gain a holistic view of the true nature of the risks a company does and does not pose.

**Goal Should Be to Reduce Systemic Risk.** FSOC must recognize that its goal is not to impose punitive regulation on financial companies, but to reduce systemic risk. If FSOC is true to that goal, it will work with companies to consider approaches to reducing systemic risk before, during, and after consideration of a company for designation. To do otherwise fails to provide the protection to the economy that Congress envisioned when it passed Dodd-Frank and instead only causes significant market distortions and increased costs for consumers with little significant benefit.

**Insurance Is Not Systemically Risky.** There was widespread recognition during the legislative process that led up to the passage of Dodd-Frank that traditional insurance activities simply are not systemically risky. Property-casualty insurers, in particular, have low leverage, are not interconnected with other financial firms, do not pose a “run-on-the-bank” threat, are highly competitive with low market concentration, have low failure rates, and have their own effective and self-financed resolution system. When one of Dodd-Frank’s namesakes, former House Financial Services Committee Chairman Barney Frank, testified last summer in a hearing assessing the Act, he said that he didn’t believe “asset managers or insurance companies that just sell insurance are systemically important.” Mr. Frank also said it was never his intention that a nonbank designated by the FSOC should be regulated as a SIFI in perpetuity, and noted that he had sent a letter to FSOC stating that view.

**Transparent, Activities-Based Analysis.** FSOC needs to make its systemic risk determinations more systematic and transparent. This includes following the mandate of Section 113 of Dodd-Frank to assess the *activities* in which a company engages – not just its size and hypothetical scenarios of financial distress. It also includes identifying activities that pose systemic risk and publicly announcing them *before* designating a company as systemically important. This will allow companies to reduce systemic risk before it becomes necessary for FSOC to consider designation. This would provide much greater confidence to the general public that true systemic risk is being addressed and rooted out of the economy.

Indeed, the GAO noted that “FSOC’s public documents have not always fully disclosed the rationales for its determination decisions” and that “the lack of full transparency has resulted in questions about the process and may hinder accountability and public and market confidence in the process.” The GAO recommended that “making FSOC’s designation process more systematic and transparent could bolster public and market confidence in the process and also help FSOC achieve its intended goals.”

**Off-Ramp.** Once a company has been designated, a fair process is needed to give the company a reasonable roadmap for eliminating the activities that led to the determination so that the company can be de-designated. There is no process for this now, but this is also essential to achieving the goal of reducing systemic risk.

**Deference to Functional Regulators.** Although almost all members of FSOC are regulators, no single member has expertise in all sectors of the financial services industry. In keeping with congressional direction in Section 113(a)(2)(H) of Dodd-Frank, FSOC *must* begin to recognize and utilize the expertise of the primary functional regulators and engage in meaningful analysis of how that regulation can or does work to reduce systemic risk. This is especially true with respect to insurance because the vast majority of FSOC members have no background in that industry or its regulation. This means, in part, being more mindful of the strong views of insurance experts on the FSOC, but even more importantly, it means consulting with state

insurance regulators before and during the designation process. The non-insurance expert members of FSOC need to devote significant time and attention to the state-based regulatory system and develop a much more sophisticated understanding of it before considering another insurance company for designation.

**Congressional Legislation.** While increased Congressional oversight of FSOC is important, Congress needs to consider statutory changes to more tightly direct FSOC's decision-making processes. For example, H.R. 1550, introduced by Representatives Dennis Ross (R-FL), and John Delaney (D-MD), would make a good start. The bill would require FSOC to:

- consider the appropriateness of the imposition of prudential standards as opposed to other forms of regulation to mitigate the identified risks;
  - at least annually reconsider nonbank SIFI designations and to respond with specificity how the Council assessed any material factors presented by the company to contest such designation;
  - revote nonbank SIFI designations every five years at the request of the affected company, including consideration of a plan by the company to reduce its systemic impact;
  - notify a nonbank financial company that it has been identified for a potential SIFI designation and to provide with specificity the basis for the consideration, an opportunity to meet with FSOC to discuss FSOC's analysis, and a list of the public sources of information being considered by the Council as part of such analysis;
  - before making a designation, vote to approve a resolution that identifies with specificity any risks to the financial stability of the United States FSOC has identified relating to the nonbank financial company;
  - provide a potential designee's primary financial regulatory agency at least 180 days from the date of the resolution to respond to FSOC regarding how the risks could be addressed by existing regulation other regulatory action to mitigate the identified risks;
- and

- every five years assess the impact of designations on SIFIs and the wider economy, including whether the designations are improving the financial stability of the United States.

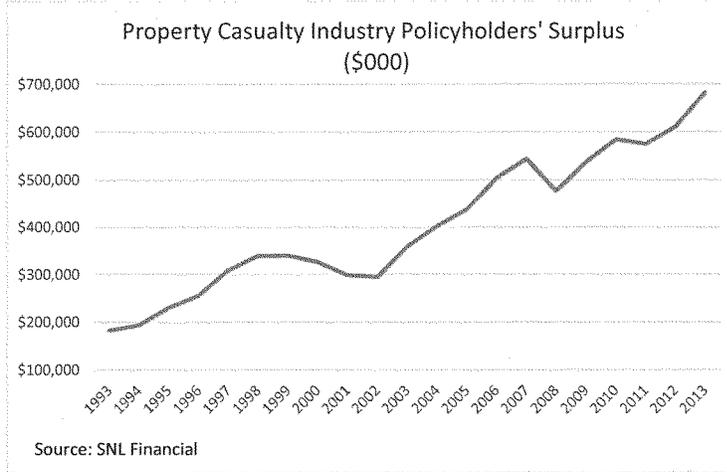
We would further urge that additional requirements for FSOC to give greater deference to functional regulators be included along with requirements to report to Congress on any designations, including detailed descriptions of how FSOC fully followed the requirements of Section 113 of Dodd-Frank.

### Conclusion

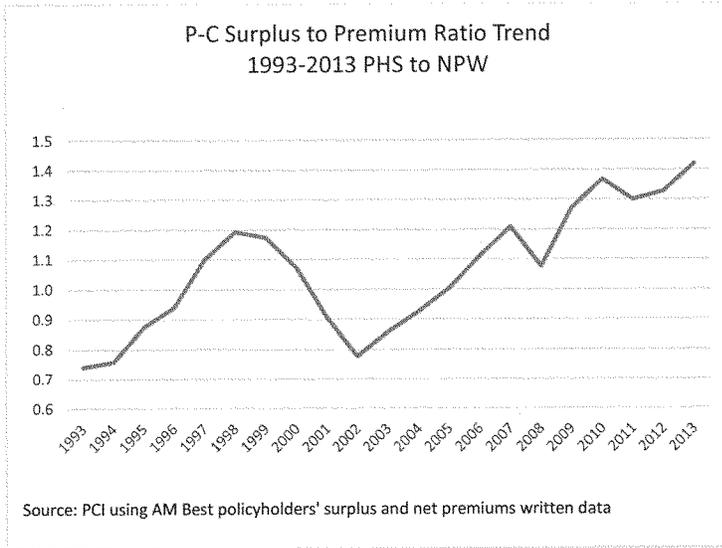
The stakes in the subjects we have addressed herein could not be higher for consumers and the competitiveness of our markets. Congress has an essential role in overseeing the increasing federal and international intrusion into the well-established state-based system of insurance regulation, encouraging greater collaboration and transparency in standard-setting discussions, and providing clear guidance to federal officials as they interface with a state-based regulatory system and international globalization pressures. Congress should help guide our country's involvement at the IMF, FSB and IAIS to facilitate a stronger global insurance regulatory environment through cooperation, coordination and consistency, as opposed to creating one-size-fits-all standards for every country in the world. New requirements and changes should be based on existing identified gaps in consumer protection. We must avoid a systemically dangerous over-reliance on uniformity, and we must not disregard the fundamental differences in regulatory and legal systems or fail to adequately consider potential costs. Congress can also encourage the regulators not only to meet together as Team USA but to develop a common strategy to support the U.S. overseas in all international insurance regulatory discussions. Domestically, Congress can ensure that federal involvement with insurers is appropriately tailored to specific regulatory objectives (such as protection of a significant thrift or overseeing specifically identified systemically important activities not currently regulated for solvency) and does not undermine the primary mission of state insurance regulation to protect consumers.

We look forward to working with Congress, federal representatives, and state regulators and lawmakers to ensure the continued support for the time tested state-insurance regulatory model.

Appendix 1



Appendix 2



## Appendix 3

**PROPERTY CASUALTY Market Concentration Analysis****DOJ Considers Score of 1500 - 2500 to Be Moderately Concentrated, But Almost All Insurers Fall Well Below**

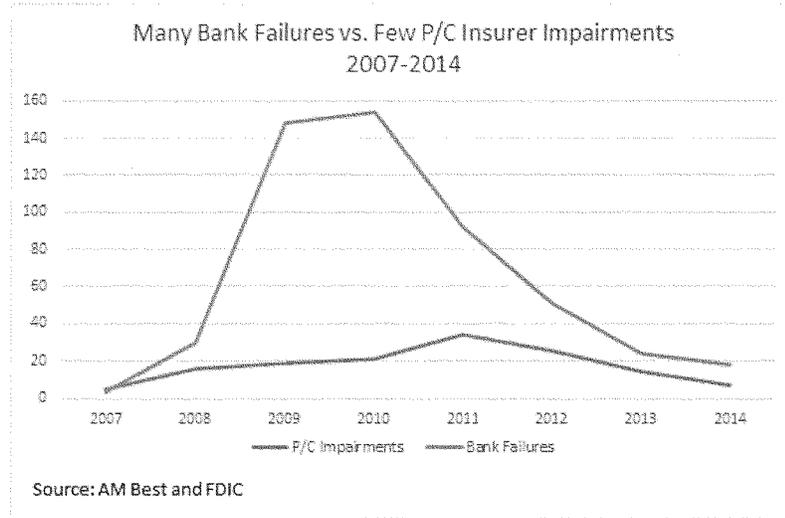
Herfindahl-Hirschman Index (HHI) based on 2013 U.S. Total (all states and DC)

Line	HHI Indiv. Cos.	Number of Indiv. Cos.
Homeowners	301.9	873
Personal Auto	349.0	877
Commercial Multi-Peril	88.6	800
Workers Compensation	88.9	704
Medical Prof. Liability	216.2	343

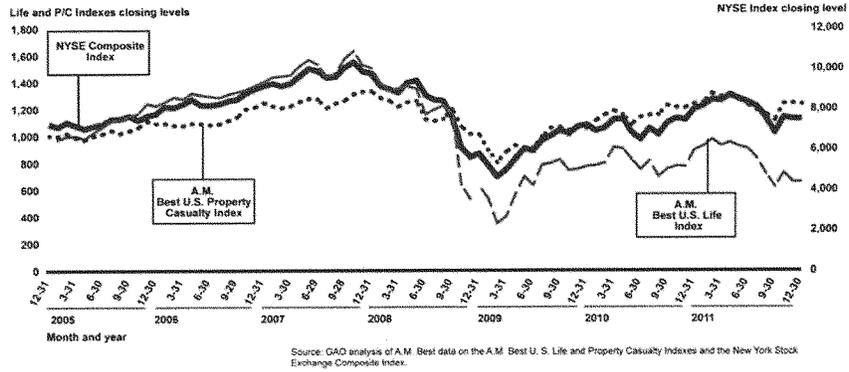
**Notes:**

1. The HHI takes into account the relative size and distribution of the firms in a market and approaches zero when a market consists of a large number of firms of relatively equal size. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.
  2. Markets in which the HHI is between 1500 and 2500 points are considered to be moderately concentrated, and those in which the HHI is in excess of 2500 points are considered to be concentrated.
- Source: NAIC Annual Statement Database via SNL Financial

Appendix 4

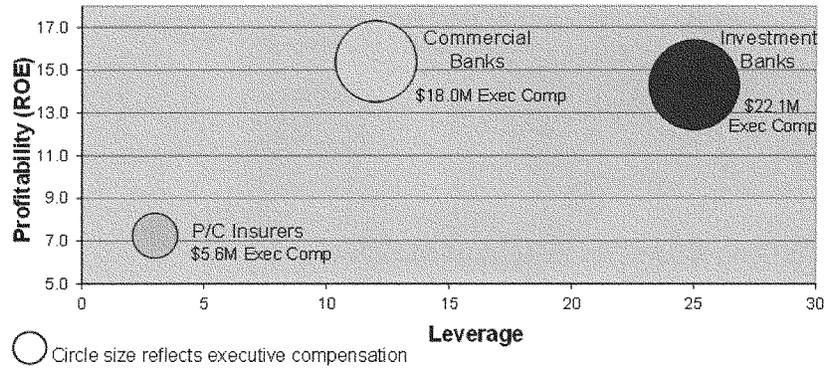


Appendix 5



Appendix 6

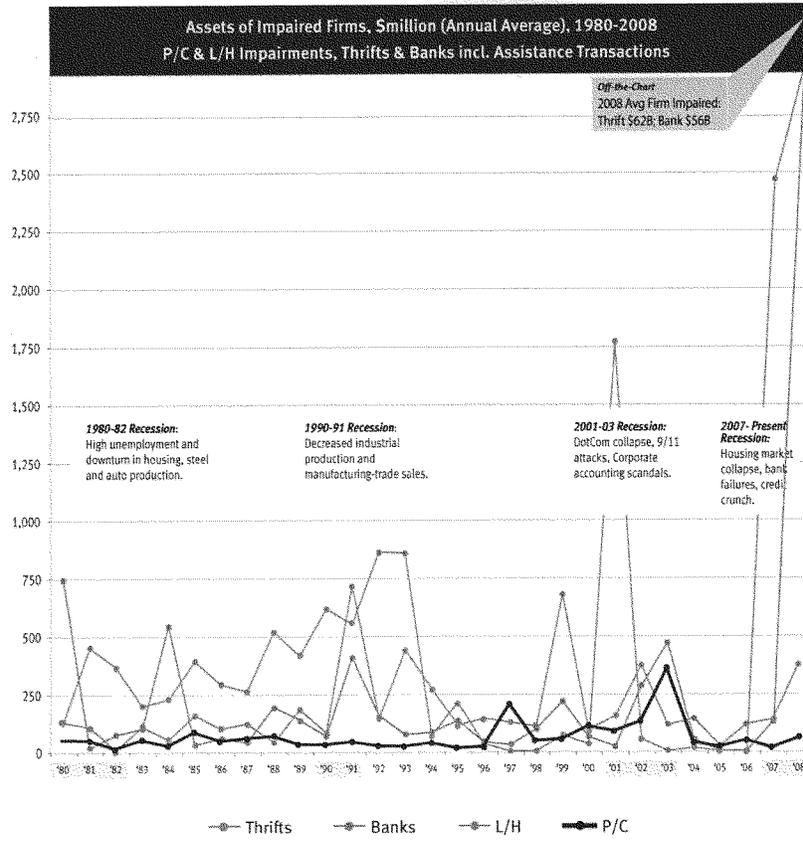
**Financial Industry Sector Distinctions**  
Profitability, Leverage and Executive Compensation



Source Information:

1. Profitability is based on industry 1998-2007 average annual rate of return; Insurance Information Institute, and Securities Industry and Financial Markets Association.
2. Leverage reflects 2007 Property/Casualty, commercial bank and investment bank results; 2009 *Economic Report of the President* (banks) and PCI calculations of total liabilities as a proportion of net admitted assets using A.M. Best data (insurers). Chart depicts investment banks levered 25 to 1; commercial banks 12 to 1; and PROPERTY CASUALTY insurers 3 to 1.
3. Executive compensation is based on 2004-2008 annual average CEO compensation from the top three firms in 2008 where data are publicly available; Morningstar.com and for State Farm, PROPERTY CASUALTY Annual Statements and Pantagraph.com newspaper article. Please note the commercial banks figure is based on the 2<sup>nd</sup>, 3<sup>rd</sup> and 5<sup>th</sup> largest firms; and the investment banks figure is based on the 2<sup>nd</sup>-4<sup>th</sup> largest firms. In the chart above, the size of each industry's circle represents executive compensation: PROPERTY CASUALTY insurers \$5.6 million; commercial banks \$18.0 million; and investment banks \$22.1 million.

Appendix 7



## Appendix 8

## U.S. NAIC Model Changes Since 2010 Related to International Pressures

Group Supervision: FSAP Recommendation

- 2010 revisions to the Model Insurance Holding Company System Regulatory Act and Insurance Holding Company System Model Regulation; these are accreditation standards for all states and include the following:
  - Created Supervisory College requirement for international insurers
  - Created Enterprise Risk Reporting Requirement for all insurance groups
  - Added access to Financial Reporting of any affiliates of a group (even non-insurance)
  - Expanded filing requirement for intercompany agreements and amendments
- 2014 additional revisions to the Model Insurance Holding Company System Regulatory Act to create definition, designation and authorities of a group-wide supervisor for international companies; in process to become an accreditation standard for all states
- **48 states have enacted the 2010 model act or have bills awaiting signature with the remaining states to enact by year-end; 7 states have enacted some version of the 2014 model**

Enterprise Risk Assessment: FSAP Recommendation

- 2011, 2012 ORSA Guidance Manual and Risk Management Own Risk and Solvency Assessment Model Act adoption – to require an Enterprise Risk Management function as well as annual assessment and reporting for companies of a size over \$500 million premium or insurance groups over \$1 billion; in process to become an accreditation standard for all states
- **28 states have enacted the 2012 ORSA model act or have bills awaiting signature with 11 more states pursuing in 2015; the ORSA guidance manual applies automatically to these states**

Reinsurance: EU/US Dialogue Recommendation

- 2011 revisions to Credit for Reinsurance Model Act and Regulations – significantly reducing collateral requirements for foreign reinsurers; an accreditation standard for states
- **At least 28 states have enacted the 2011 revisions to the model act**

Capital Adequacy: FSAP Recommendation

- 2013 added Catastrophe Risk Based Capital Factors for Earthquake and Hurricane risks
- 2014 added Operational Risk Based Capital Factors
- 2013-2014 Investment Risk Based Capital Factors – under evaluation and reassessment
- **All RBC changes will be automatically applied to all states; no adoption necessary**

Corporate Governance: FSAP Recommendation

- 2014 Corporate Governance Annual Disclosure Model Act; in process to become an accreditation standard for all states
- **One state enacted this new model with two awaiting governor signatures**

Internal Audit: FSAP Recommendation

- 2014 Internal Audit Function Requirement added to Model Audit Rule for companies of a size over \$500 million premium or insurance groups over \$1 billion; in process to become an accreditation standard for all states



STATEMENT BEFORE THE U.S. HOUSE OF REPRESENTATIVES FINANCIAL SERVICES COMMITTEE HOUSING AND INSURANCE SUBCOMMITTEE, "THE IMPACT OF INTERNATIONAL REGULATORY STANDARDS ON THE COMPETITIVENESS OF U.S. INSURERS." April 29, 2015

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

PIA opposes any federal or international effort that would undermine the state-based system of insurance regulation, such as creating a federal regulator of insurance or adopting a one-size-fits-all approach to global insurance regulation. States are the primary regulators of insurance in the U.S.; however, developments at the international level can heavily influence laws and regulations at the state level. If global standards are developed without appropriate consideration of the unique state-based system of insurance regulation, they may actually increase systemic risks and consumer costs by pushing small and midsize companies out of business and reducing competition.

PIA is concerned that international efforts to increase capital standards on insurance companies will lead to higher consumer costs, without corresponding consumer protections. Recent research by Sonecon and the American Enterprise Institute found that not only are international efforts to increase capital standards on property and casualty insurance companies unnecessary, but could raise homeowners' insurance premiums by as much as eight percent. The same research also found that higher capital standards will reduce coverage options for consumers.

PIA supports coordination and cooperation between state officials, federal officials, and international bodies to ensure that state insurance regulation is afforded appropriate deference in any federal or international decision-making process. The U.S. Department of Treasury, the Federal Insurance Office (FIO), the Federal Reserve Board, the Securities and Exchange Commission, and the National Association of Insurance Commissioners (NAIC) all represent the U.S. in some capacity in important international insurance discussions at the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS).

PIA supports legislation that would require consultation with Congress, the insurance industry, and consumers with respect to domestic and international insurance standards, negotiations, regulations, or frameworks. International negotiations can have serious consequences for the domestic insurance industry, as well as its consumers, and should be handled in a transparent manner, which should

include the opportunity for public comments to be made on proposed agreements throughout the deliberative process.

For over 150 years the state-based system of insurance regulation has worked, successfully protecting consumers and creating a competitive and diverse U.S. insurance market. PIA looks forward to continuing our engagement with Congress on these important issues in the months ahead and thanks the committee for holding this hearing today.

## Questions for the Record

Hearing entitled "The Impact of International Regulatory Standards on the Competitiveness of the U.S. Insurers."

Rep. Scott Garrett

1. Commissioner McCarty: Mr. Woodall testified in the Senate stating, "If U.S. Federal government officials at the FSB are to commit, on behalf of the U.S. to implement international insurance standards in the U.S., then given the regulatory structure endorsed by Congress, I believe that the outcome of any such commitment should be consistent with proven effective State-based regulation."

Are you concerned that any new international capital standards should be consistent with the current state-based capital standards?

Yes, and I agree with Mr. Woodall's assessment. During the recent financial crisis our state-based system of insurance regulation in particular performed well, and our insurers were well capitalized. The development of new global capital standards or benchmarks for international groups only makes sense as an additional cross-border cooperation tool for all supervisors of these groups, but it cannot and will not replace our state legal-entity system to protect policyholders. Our primary objective continues to be to ensure that such standards are adaptable to the United States market and regulatory regime, and ultimately serve to benefit and protect U.S. consumers. State insurance regulators will not implement any international standard that is inconsistent with our time-tested solvency regime that puts the interests of policyholders first.

Do you think it would be constructive for Congress to mandate that in law?

Congress has an important role to play in overseeing the international insurance roles and policy objectives of the U.S. federal agencies participating in international standard-setting activities at the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board (FSB), and should express its views to these agencies in any way that it deems appropriate. We strongly support greater clarity and transparency of federal policy objectives in this area, especially since we remain the primary regulators of insurance in the United States.

2. Commissioner McCarty: If the new proposed International Capital Standard (ICS) is consistent with current state-based capital requirements, why do we need a new international standard? What is the purpose of establishing a new standard that would be similar or identical to the one currently in place? Would that cause needless confusion in the marketplace?

Given the different regulatory structures and approaches around the world, international capital standards should be flexible and focused on a common outcome, and not a prescriptive mandate. We are working at the IAIS to ensure that any standards that emerge from the IAIS are compatible with our system, not because we seek to impose our approach on the rest of the world, but rather because our approach works for U.S. consumers and we will not see it arbitrarily changed without justification. We do, however, see value in assessing and understanding the capital adequacy of a complex firm at the group level, and are working through our open NAIC process to consider such an approach. Should the ICS be consistent with what we develop and implement, then additional steps to adopt a separate standard are not

necessary. If the ICS is inconsistent with our approach, and should we see no merit in incorporating those differences into our system, then we would not advocate for its adoption in the state legislatures and would urge Congress to defer to, if not reinforce that stance.

3. To all witnesses: Currently an ICS for IAIGs is being developed. Will this standard contain the force of law? Or does it have to be implemented, voluntarily, by each of the state insurance commissioners who have the legal authority to regulate solvency for domestic non-SIFI, non-SLHC insurers. What happens if some state insurance commissioners refuse to implement the new standard? Does it have any impact? Will the Europeans and others freeze U.S. domestic insurers not in compliance with the “international standards” out of overseas markets? Isn’t that the stick that is created for international regulators when the ICS is complete?

International standards, such as the ICS, do not have the force of law. It is up to the individual members of the IAIS to implement standards if they choose in a manner appropriate to their markets. The pressure imposed on regulators by the G20 and the FSB to implement international standards is premised on the notion of ensuring all players in a global financial system are well regulated and well capitalized. We believe our market is already both.

It is a concern that Europeans and others could use any overly prescriptive international standard (even one created over the objections of state insurance regulators) to impact the ability of U.S. insurers to compete in overseas markets or penalize them if their domestic regulator, the U.S., is not following the international standards verbatim. This type of regulatory retaliation can cut both ways, but is a result we should all seek to avoid and instead work to build an understanding and trust in our respective systems, and not try to impose one jurisdiction’s system on another.

4. Deputy Director Van Der Weide and Director McCrath: Recently, in a speech at the Harvard Law School, SEC Commissioner Dan Gallagher stated:

“It remains the height of regulatory hubris to assume that not only is there a single regulatory solution to any given problem facing our markets, but that a handful of mandarins working in an opaque international forum can find those perfect solutions. In reality, while such regulators may get some things right, they will most certainly get things wrong – and, having coerced the world to do it all one way, it will go wrong everywhere.

“There is no better example of this peril of this type of regulatory group-think than the capital standards set by the Basel Committee. In the pre-crisis era, these standards, among other things, classified residential mortgage-backed securities as lower risk instruments than corporate or commercial loans. Banks naturally responded to the incentives set under Basel rules in constructing their balance sheets, resulting in homogenous – and, as we now know, ultimately disastrous – business strategies and asset concentrations. When the housing bubble burst, the banks realized too late that these assets were toxic.”

Given the failed track record of the standard-setting through the Basel process, isn’t there a greater likelihood that setting similar or identical global standards for insurance companies will increase the risk of a financial crisis. Won’t these actions actually decrease financial stability?

Questions for the Record  
Chairman Blaine Luetkemeyer (MO-03)  
Committee on Financial Services  
Subcommittee on Housing and Insurance  
U.S. House of Representatives

“The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers”

Hearing held April 29, 2015

Questions for Michael McRaith, Federal Insurance Office, U.S. Department of the Treasury:

1. Is it important that the U.S. develop insurance standards before agreeing to any sort of international standard? Will you commit to this body that you will not agree to an international standard before the domestic standard has been finalized?
2. Some have expressed concerns that the Administration would use the authority under Dodd Frank for a covered agreement to achieve an agreement on international capital standards with the IAIS. Would you allow an international capital standard to be included in a reinsurance-focused covered agreement? Would a covered agreement allow for any opportunity to discuss, agree to, or impose an international capital standard on U.S. insurers? Do you believe that any capital standard should be promulgated as a standalone agreement?
3. Director McRaith, the European Union has indicated interest in moving forward soon, but this Committee has yet to hear from FIO or the U.S. Trade Representative. What is the timeline for a covered agreement at the IAIS?

Questions for Mark Van Der Weide, Federal Reserve Board of Governors:

1. How much does the Fed's work at the FSB and IAIS influence the development of domestic capital rules? Are they mutually exclusive?
2. The Fed is statutorily required to create and implement a domestic capital standard on certain U.S. insurers. Do you believe it essential that you do so before agreeing to any kind of international capital standard?
3. Prior to any final insurance capital standards rule being adopted, will the Board undertake one or more additional Quantitative Impact Studies to gather additional information regarding the appropriateness of any capital framework under consideration on the insurance business model?
4. During your congressional testimony, you noted that the Board would engage in a formal rulemaking process, including a notice of proposed rulemaking, to adopt capital standards

for insurance savings and loan holding companies and insurance SIFIs. In other contexts where the Board is engaging in a new area of regulations, most recently, around the rules governing the ownership of commodities by bank holding companies, the board has issued an advanced notice of proposed rulemaking to maximize the opportunities for stakeholder input. Given the importance of the insurance capital rules, will the Board issue an advanced notice of public rule making?

5. Do you believe that bank-like standards would disadvantage the U.S. insurance industry? Would you support bank-centric insurance standards developed by foreign regulators?
6. How far does the Fed's statutory authority to regulate insurers go (not just with regard to SLHC and SIFIs and not just domestically domiciled insurers that operate internationally)? What is the Fed's statutory authority to regulate large globally-active insurers that are not SIFIs?

Questions for Kevin McCarty, Office of Insurance Regulation, State of Florida:

1. I understand from the hearing that FIO, the Federal Reserve, and the NAIC have frequent communication and participate in a number of calls to discuss international insurance standards. As a result of these ongoing discussions, do you have a clear sense of what your federal colleagues' specific views and objectives are for the development of an international capital standard? Do state insurance regulators articulate their views to FIO and/or the Federal Reserve?

We have received very little in writing or on public record from our federal colleagues, and there is significant room for improvement. Communication and coordination among federal agencies and state insurance regulators is essential to fostering a collaborative U.S. approach to international standard-setting activities at the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board (FSB). While we appreciate the current levels of communication with FIO and the Federal Reserve, and we certainly exchange views on some matters, we do not have a clear picture of their policy objectives or level of commitment to ensure that U.S. federal policy is consistent and compatible with our state-based system. The U.S. insurance sector, including company and consumer stakeholders, is handicapped because U.S. state insurance regulators are not engaged directly with the FSB on insurance matters, and because of the FSB's lack of transparency and the recent retreat from open sessions at the IAIS. We would encourage more transparency across the board from the international standard-setting organizations and the U.S. Federal government agencies in activities relating to international insurance standards.

State insurance regulators do articulate their views to FIO and the Federal Reserve. State insurance regulators are committed to providing an open and inclusive forum through the NAIC that provides transparency into the development of our policy positions and has proven effective for many years. We believe it is important to articulate our views on

international capital standards not only to our federal colleagues, but also to the larger stakeholder community. That is why we have been engaged in an open and public process with our federal colleagues, industry, and consumer stakeholder through our ComFrame Development and Analysis Working Group (CDAWG) to update our position statements on ComFrame and international capital development. These public documents are posted on our NAIC website and serve to articulate state insurance regulators' views toward the uses of capital within prudential regulation and help guide our ongoing work regarding IAIS capital proposals.

**Rep. Ed Royce (CA-39)**

**HI Subcommittee Hearing entitled: "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers."**

**04.29.15**

**Questions for the Record**

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Mr. Kevin McCarty, Commissioner, Florida Office of Insurance Regulation, on behalf of the National Association of Insurance Commissioners

Mr. McCarty, you testified that: "We have an approach at the NAIC as you may be aware, a very transparent process for open discussion and dialog, pros and cons and developing positions." You contrasted this to other regulators very favorably.

NAIC acts as a public policy making body, developing model laws which are often subject to its accreditation process, and developing standards found in its handbooks which become law through incorporation by reference. Yet NAIC often does not observe open meetings requirements. As I have noted before, it has an open meetings policy that exempts all of the meetings of the commissioners as a group at commissioners' conferences, roundtables, retreats, etc.

#### **QUESTIONS**

In your time as a commissioner, have the commissioners ever had "discussion and dialog, pros and cons and developing positions" at the commissioners conference, roundtable discussions, retreats, etc., subject to the exemption in the NAIC open meetings policy?

The NAIC is committed to conducting its business openly and any action taken on NAIC model laws, regulations or other guidance by any NAIC committee, subcommittee, task force or working group is taken in open session. The NAIC is also committed to providing a forum for its members to have frank and candid discussions among themselves concerning regulatory issues.

In your time as commissioner, has the NAIC always followed its open meetings policy? Have meetings of NAIC committees not subject to the exemption followed the policy? Has the executive committee met in closed meetings in connection with commissioners' conferences and retreats? Is this in compliance with the NAIC open meetings policy? Have meetings of other committees always followed the open meetings policy requirements with respect to closing meetings?

In my experience, the NAIC follows its open meetings policy. Last year we revised the policy to provide for notice of all regulator only meetings and other changes and I believe those changes have been fully implemented.

There was a recent article in the Florida press regarding your use of the NAIC credit card. You commendably gave permission for the public to learn about your ability, as a public official, to enjoy the benefits of a credit card provided by the NAIC. If the NAIC is a

“transparent” organization, shouldn’t it open its books so that the public can see the credit card records of the public officials? Will you, a former NAIC president and frequent NAIC witness at Congressional hearings, ask the NAIC to turn over all the credit card records of its member commissioners?

As a state official of Florida, my travel and expenses are subject to oversight by various state bodies and I assume that is the case for other commissioners. When I requested documentation of my NAIC-related expenses, the NAIC did not hesitate to provide those records to me and I am confident they would do so for any of our members. However, in my view, disclosure of these records should be in conjunction with a state’s oversight of its insurance commissioner and not unilaterally determined by the NAIC or its leadership.

*Questions for the Record for Mr. Michael McRaith  
Director, Federal Insurance Office, U.S. Department of the Treasury  
Hearing entitled "The Impact of International Regulatory Standards on the Competitiveness of the U.S. Insurers."  
House Financial Services Committee (Subcommittee on Housing and Insurance)  
Hearing Held April 29, 2015*

**From Chairman Blaine Luetkemeyer**

- 1. Is it important that the U.S. develop insurance standards before agreeing to any sort of international standard? Will you commit to this body that you will not agree to an international standard before the domestic standard has been finalized?**

Answer:

The International Association of Insurance Supervisors (IAIS) was formed in 1994 by state insurance regulators and regulators in other countries. International insurance standards have been developed, tested and then implemented in the United States for many years. The current standards, including capital standards, are in the early days of conceptual development, will be followed by impact testing at the state and federal levels, and such standards will be implemented through conventional state and federal processes in a manner tailored to the U.S. insurance market and regulatory structure. As a result, any international standard, to the extent incorporated in U.S. regulatory practice, will be incorporated in a manner tailored to U.S. interests in accordance with applicable rulemaking procedures.

- 2. Some have expressed concerns that the Administration would use the authority under Dodd Frank for a covered agreement to achieve an agreement on international capital standards with the IAIS. Would you allow an international capital standard to be included in a reinsurance-focused covered agreement? Would a covered agreement allow for any opportunity to discuss, agree to, or impose an international capital standard on U.S. insurers? Do you believe that any capital standard should be promulgated as a standalone agreement?**

Answer:

Prior to the commencement of negotiations for a covered agreement, the Federal Insurance Office (FIO) and USTR will consult with Congress, including the House Committee on Financial Services, in order to advise Congress of the potential scope, objectives, and other factors relating to the covered agreement. The Administration does not intend to include a capital standard in a covered agreement.

- 3. Director McRaith, the European Union has indicated interest in moving forward soon, but this Committee has yet to hear from FIO or the U.S. Trade Representative. What is the timeline for a covered agreement at the IAIS?**

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House Financial Services Committee (Subcommittee on Housing and Insurance)  
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Answer:

We are committed to moving forward promptly with the negotiations of a covered agreement. Prior to the commencement of negotiations of a covered agreement, FIO and USTR will consult with Congress, including the House Committee on Financial Services.

*Questions for the Record for Mr. Michael McRaith  
Director, Federal Insurance Office, U.S. Department of the Treasury  
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House Financial Services Committee (Subcommittee on Housing and Insurance)  
Hearing Held April 29, 2015*

**From Rep. Ed Royce**

- 1. Director McRaith, your prepared statement reiterates Treasury's commitment that USTR and FIO pursue a covered agreement with the EU respect to state-based reinsurance collateral requirements, and possibly group supervision and confidentiality/professional secrecy, under authority created in Title V of Dodd-Frank. Your statement also confirms the EU nations recently gave the European Commission the negotiating mandate to pursue an agreement with the United States on these same subjects. We further understand that the relevant EU Commission team will be coming to Washington the week of May 18th for an NAIC International Issues Forum and will be prepared to begin negotiations on such a possible covered agreement, which sounds like a potential win-win for the United States and Europe. Can you confirm for us that the Administration will likewise be prepared to commence negotiations at that time, including notification to this Committee and others as required by Title V?**

**Answer:**

We are committed to moving forward promptly with the negotiations of a covered agreement. Prior to the commencement of negotiations of a covered agreement, FIO and USTR will consult with Congress, including the House Committee on Financial Services.

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**From Rep. Scott Garrett**

1. **To all witnesses: Currently an ICS for IAIGs is being developed. Will this standard contain the force of law? Or does it have to be implemented, voluntarily, by each of the state insurance commissioners who have the legal authority to regulate solvency for domestic non-SIFI, non-SLHC insurers. What happens if some state insurance commissioners refuse to implement the new standard? Does it have any impact? Will the Europeans and others freeze U.S. domestic insurers not in compliance with the "international standards" out of overseas markets? Isn't that the stick that is created for international regulators when the ICS is complete?**

Answer:

International insurance standard-setting activities identify best practices for supervision that promote global financial stability and equal footing for U.S. insurers operating around the world. Standard-setting is only the first of a three step process. For the United States, after standards are developed, the standards will be tested for impact both on individual insurers and on the market as a whole. Following extensive testing, standards will be implemented at the state and federal levels in a manner tailored to the U.S. insurance market and regulatory structure.

As has always been true in the insurance sector, international standards are not self-executing. U.S. state or federal authorities may impose a standard or requirement on a U.S. insurance organization. In the case of the United States, for firms that operate as part of a bank or savings and loan holding company or nonbank financial company designated by the Financial Stability Oversight Council (FSOC), the Federal Reserve has the authority to implement the standard. For firms not subject to oversight by the Federal Reserve, the state insurance regulators would have authority to implement the standard.

There may be an impact on U.S. insurers operating abroad if the Federal Reserve Board or state insurance regulators do not adopt appropriate oversight mechanisms. For this reason, the participation and leadership provided by the United States in international standard-setting activities is essential.

2. **Deputy Director Van Der Weide and Director McRaith: Recently, in a speech at the Harvard Law School, SEC Commissioner Dan Gallagher stated:**

**"It remains the height of regulatory hubris to assume that not only is there a single regulatory solution to any given problem facing our markets, but that**

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**a handful of mandarins working in an opaque international forum can find those perfect solutions. In reality, while such regulators may get some things right, they will most certainly get things wrong – and, having coerced the world to do it all one way, it will go wrong everywhere.**

**“There is no better example of this peril of this type of regulatory group-think than the capital standards set by the Basel Committee. In the pre-crisis era, these standards, among other things, classified residential mortgage-backed securities as lower risk instruments than corporate or commercial loans. Banks naturally responded to the incentives set under Basel rules in constructing their balance sheets, resulting in homogenous – and, as we now know, ultimately disastrous – business strategies and asset concentrations. When the housing bubble burst, the banks realized too late that these assets were toxic.”**

**Given the failed track record of the standard-setting through the Basel process, isn't there a greater likelihood that setting similar or identical global standards for insurance companies will increase the risk of a financial crisis. Won't these actions actually decrease financial stability?**

Answer:

The crisis demonstrated that (1) the insurance sector is an integral part of capital markets and the financial sector, and (2) the economies of different countries are increasingly connected. Further, in recent years, insurers based in the United States and elsewhere are finding opportunities for organic growth in new markets and developing economies. For these reasons, international insurance standard-setting activities are important to fostering financial stability.

International insurance standard-setting activities promote global financial stability and equal footing for U.S. insurers operating around the world. Standard-setting is only the first of a three step process. For the United States, after standards are developed, the standards will be tested for impact both on individual insurers and on the market as a whole. Following extensive testing, standards will be implemented at the state and federal levels in a manner tailored to the U.S. insurance market and regulatory structure.

At the same time, U.S.-based insurers are pursuing growth opportunities in developing economies around the world. Improved supervisory understanding of the insurers operating in markets around the world improves awareness of risk, or potential risk, within those insurers and within national economies.

**Questions for The Honorable Mark Van Der Weide, Deputy Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System from Representative Garrett:**

**1. To all witnesses: Currently an ICS for IAIGs is being developed. Will this standard contain the force of law? Or does it have to be implemented, voluntarily, by each of the state insurance commissioners who have the legal authority to regulate solvency for domestic non-SIFI, non-SLHC insurers. What happens if some state insurance commissioners refuse to implement the new standard? Does it have any impact? Will the Europeans and others freeze U.S. domestic insurers not in compliance with the “international standards” out of overseas markets? Isn’t that the stick that is created for international regulators when the ICS is complete?**

The standards under development by the International Association of Insurance Supervisors (IAIS) would not be binding in the United States. They are not self-executing. They would only apply in the United States if adopted by the appropriate U.S. regulators in accordance with applicable domestic laws and rulemaking procedures. Additionally, none of the standards are intended to replace the existing legal entity risk-based capital requirements that are in place. The Federal Reserve participates as a member of the IAIS along with our fellow U.S. members from the Federal Insurance Office and National Association of Insurance Commissioners. Along with these organizations, we advocate for the development of international standards that best meet the needs of the U.S. insurers and U.S. consumers.

**2. Deputy Director Van Der Weide and Director McGrath: Recently, in a speech at the Harvard Law School, SEC Commissioner Dan Gallagher stated:**

**“It remains the height of regulatory hubris to assume that not only is there a single regulatory solution to any given problem facing our markets, but that a handful of mandarins working in an opaque international forum can find those perfect solutions. In reality, while such regulators may get some things right, they will most certainly get things wrong – and, having coerced the world to do it all one way, it will go wrong everywhere.**

**“There is no better example of this peril of this type of regulatory group-think than the capital standards set by the Basel Committee. In the pre-crisis era, these standards, among other things, classified residential mortgage-backed securities as lower risk instruments than corporate or commercial loans. Banks naturally responded to the incentives set under Basel rules in constructing their balance sheets, resulting in homogenous – and, as we now know, ultimately disastrous – business strategies and asset concentrations. When the housing bubble burst, the banks realized too late that these assets were toxic.”**

**Given the failed track record of the standard-setting through the Basel process, isn’t there a greater likelihood that setting similar or identical global standards for insurance companies will increase the risk of a financial crisis. Won’t these actions actually decrease financial stability?**

A goal of the international capital standard (ICS) being developed by the IAIS is to achieve greater comparability of the group-wide capital requirements of internationally active insurance groups across jurisdictions. A well-designed ICS should promote global and U.S. financial stability, provide a more level playing field for internationally active U.S. insurance firms and enhance supervisory cooperation and coordination among group-wide and host insurance supervisors. As stated in my previous answer, global standards are not self-executing. They would only apply in the United States if adopted by appropriate U.S. regulators in accordance with applicable domestic laws and rulemaking procedures.

**Questions for Mark Van der Weide, Deputy Director, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:**

**6. How far does the Fed's statutory authority to regulate insurers go (not just with regard to SLHC and SIFIs and not just domestically domiciled insurers that operate internationally)? What is the Fed's statutory authority to regulate large globally-active insurers that are not SIFIs?**

In addition to nonbank financial companies that the Financial Stability Oversight Council (FSOC) has determined should be subject to Federal Reserve supervision, the Federal Reserve is the consolidated federal regulator of bank holding companies (BHCs), savings and loan holding companies (SLHCs), and certain foreign banking organizations with U.S. operations (FBOs). In some instances, these supervised entities are insurance companies or on a consolidated basis have subsidiaries that are insurance companies. The Federal Reserve's authority to supervise these entities is provided in the Bank Holding Company Act of 1956, Home Owners' Loan Act, International Banking Act, Federal Reserve Act, Federal Deposit Insurance Act, and the Dodd-Frank Wall Street Reform and Consumer Protection Act. An internationally active insurance group identified by the International Association of Insurance Supervisors would be subject to Federal Reserve supervision only if the FSOC determined that the firm should be subject to supervision by the Federal Reserve or if the firm was a BHC, SLHC, or FBO subject to oversight by the Federal Reserve through the aforementioned authorities.

**Questions for The Honorable Mark Van der Weide, Deputy Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System from Chairman Luetkemeyer:**

**1. How much does the Fed's work at the FSB and IAIS influence the development of domestic capital rules? Are they mutually exclusive?**

The Insurance Capital Standard (ICS) under development within the International Association of Insurance Supervisors (IAIS) does not have a fixed timeline. The IAIS continues to develop the ICS and intends to allow for multiple rounds of field testing to assure the impact of any standard is understood before it is finalized. The Federal Reserve currently is participating in these deliberations at the IAIS along with our fellow U.S. members from the Federal Insurance Office and National Association of Insurance Commissioners. Along with these organizations, we advocate for the development of international standards that best meet the needs of the U.S. insurers and U.S. consumers. We note that the standards under development by the IAIS would not be binding in the United States. They are not self-executing. International regulatory standards cannot be imposed on U.S. firms by an international body; rather, these standards apply in the United States only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures conducted here. Additionally, none of the IAIS standards are intended to replace the existing legal entity risk-based capital requirements that are already in place for U.S. insurance companies.

The Federal Reserve continues to focus on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance. We are committed to a transparent rulemaking process and are engaging stakeholders at various levels. The timeline for the development of our rulemaking is distinct from the activities of the IAIS. We are exercising great care as we approach this challenging mandate.

**2. The Fed is statutorily required to create and implement a domestic capital standard on certain U.S. insurers. Do you believe it essential that you do so before agreeing to any kind of international capital standard?**

Our obligations under the law are distinct from the standard setting activities of the IAIS. That said, we would advocate for an international standard which is in the best interests of U.S. consumers, the U.S. insurance market, and U.S. insurers. Waiting to participate in IAIS deliberations on the international capital standards until after our domestic insurance capital standard is finalized could decrease the influence that the United States has over the international standards and could result in those standards being less tailored to our insurance market, to the detriment of U.S. policyholders.

**3. Prior to any final insurance capital standards rule being adopted, will the Board undertake one or more additional Quantitative Impact Studies to gather additional information regarding the appropriateness of any capital framework under consideration on the insurance business model?**

Last year, the Federal Reserve conducted an extensive quantitative impact study (QIS) prior to the S. 2270, The Insurance Capital Standards Clarification Act of 2014. The data we collected

helps inform us as to the insurance risks of the firms that participated. We collected an extensive amount of data.

The Federal Reserve continues to assess whether and when an additional QIS would be warranted in connection with our domestic insurance capital standard rulemaking process.

**4. During your congressional testimony, you noted that the Board would engage in a formal rulemaking process, including a notice of proposed rulemaking, to adopt capital standards for insurance savings and loan holding companies and insurance SIFIs. In other contexts where the Board is engaging in a new area of regulations, most recently, around the rules governing the ownership of commodities by bank holding companies, the board has issued an advanced notice of proposed rulemaking to maximize the opportunities for stakeholder input. Given the importance of the insurance capital rules, will the Board issue an advanced notice of public rule making?**

After the changes made in S. 2270, The Insurance Capital Standards Clarification Act of 2014, we now have the flexibility to tailor a capital standard to the business of insurance. We are exercising great care as we move forward with this challenging mandate and continue to assess whether to issue an advance notice of proposed rulemaking. We remain committed to following a transparent rulemaking processes that will allow for an open public comment period on a concrete proposal. We will continue to engage with interested parties as we move forward.

**5. Do you believe that bank-like standards would disadvantage the U.S. insurance industry? Would you support bank-centric insurance standards developed by foreign regulators?**

The Federal Reserve believes it is important that capital standards for insurance holding companies be tailored to the business of insurance. We appreciate the support of Congress in giving us this flexibility domestically through the passage of S. 2270, the Insurance Capital Standards Clarification Act of 2014. We would not support any international insurance capital standard that is not appropriately tailored to the business of insurance.

**Questions for The Honorable Mark Van Der Weide, Board of Governors of the Federal Reserve System from Representative Westmoreland:**

**1. Mr. Van Der Weide, please provide the statutory citation and language that permits the Federal Reserve to determine appropriate capital requirements for non-bank SIFIs? Additionally, please provide the statutory citation and language that permits the Federal Reserve to determine appropriate capital requirements for Savings and Loan Holding Companies. Finally, please provide the statutory citation and language permitting the Federal Reserve to determine appropriate capital requirements for Internationally Active Insurance Groups.**

The statutory authority for the Federal Reserve to establish capital requirements for nonbank financial companies supervised by the Board is at 12 U.S.C. § 5365(b)(1)(A) (section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act). In relevant part, this provision states:

“(A) Required standards. The Board of Governors shall establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that shall include –

(i) risk-based capital requirements and leverage limits, unless the Board of Governors, in consultation with the Council, determines that such requirements are not appropriate for a company subject to more stringent prudential standards because of the activities of such company (such as investment company activities or assets under management) or structure, in which case, the Board of Governors shall apply other standards that result in similarly stringent risk controls; . . .”

The statutory authority for the Federal Reserve to establish capital requirements for savings and loan holding companies is at 12 U.S.C. 1467a(g)(1) (section 10 of the Home Owners Loan Act). This provision states:

“(g) Administration and enforcement

(1) In general. The Board is authorized to issue such regulations and orders, including regulations and orders relating to capital requirements for savings and loan holding companies, as the Board deems necessary or appropriate to enable the Board to administer and carry out the purposes of this section, and to require compliance therewith and prevent evasions thereof. In establishing capital regulations pursuant to this subsection, the appropriate federal banking agency shall seek to make such requirements countercyclical so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company.”

The Federal Reserve has prudential supervisory responsibility regarding insurance companies that are part of bank holding companies or savings and loan holding companies, or have been designated by the Financial Stability Oversight Council as nonbank financial companies. The primary statutory authorities for the Federal Reserve to establish capital requirements for savings and loan holding companies and nonbank financial companies supervised by the Board are provided above. The statutory authority for the Federal Reserve to establish capital requirements

for bank holding companies is at 12 U.S.C. § 1844(b) (section 5 of the Bank Holding Company Act). This provision states:

“(b) Regulations and orders. The Board is authorized to issue such regulations and orders, including regulations and orders relating to the capital requirements for bank holding companies, as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof. In establishing capital regulations pursuant to this subsection, the Board shall seek to make such requirements countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company.”

