THE FEDERAL GOVERNMENT'S ROLE IN THE INSURANCE INDUSTRY

HEARING

BEFORE THE

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HOUSING AND INSURANCE

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THE FEDERAL GOVERNMENT'S ROLE IN THE INSURANCE INDUSTRY

Tuesday, October 24, 2017

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

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Sean Duffy [chairman of the subcommittee] presiding.

Present: Representatives Duffy, Ross, Royce, Pearce, Posey, Luetkemeyer, Stivers, Hultgren, Rothfus, Zeldin, MacArthur, Budd, Hensarling, Cleaver, Velazquez, Capuano, Sherman, Kildee, Delaney, Kihuen, Gonzalez, and Waters.

Also present: Representative Heck.

Chairman DUFFY. The Subcommittee on Housing and Insurance will come to order. Today's hearing is entitled "The Federal Government's Role in the Insurance Industry."

Without objection, the chair is authorized to declare a recess of this subcommittee at any time. Without objection, all members will have 5 legislative days to submit extraneous materials to the chair for inclusion in the record.

Without objection, members of the full committee who are not members of this subcommittee may participate in today's hearing for the purpose of making an opening statement and questioning the witnesses.

The chair now recognizes himself for an opening statement for 3 minutes. First, I want to thank our witnesses for joining us today to discuss the Federal Government's proper role in the industry of insurance.

This subcommittee held a hearing earlier this year on the first covered agreement which was subsequently signed by Treasury on September 22nd of this year. While that hearing focused on issues contained in the covered agreement, it also highlighted several issues with the process of entering into covered agreements. I hope to continue that lively and fun conversation today.

Since that hearing, I have been working with Congressman Denny Heck on legislation that would seek to reform how the FIO (Federal Insurance Office) and Congress can impact international agreements prospectively as I strongly believe we must ensure that the State-based system of insurance regulation continues to be protected.

In addition to the Federal Government's role in international insurance issues, I believe we also need to look at the FIO's role in general, including its duties at the domestic level.

The FIO has been in place since Dodd-Frank, and I have heard from many stakeholders that have called for a range of reforms of the office. Some of the most aggressive stakeholders have gone so far as to say FIO should be eliminated.

And we have folks on the other side who say we should maintain FIO and actually expand the role of FIO, two different—very different views of the role that FIO should have.

And looking at the issues historically and receiving feedback, we have an opportunity to streamline the office to focus its mission on international issues while removing its duties that are duplicative of what is already being done by State insurance commissioners and regulators.

I strongly believe that Congress should have a direct say as to whether the U.S. should enter into an international agreement, much like we do with a trade agreement, in order to ensure we are getting the best deal for our constituents.

The Treasury Department will release its views on the insurances industry as soon as possible, and I am hopeful that this new Administration continues to move in the right direction and provide signals to the international community about the strength of the U.S.-based insurance regulatory system.

I want to emphasize that in signing the covered agreement, the Treasury Department issued a unilateral statement saying, and I quote, The agreement affirms the U.S. system of insurance regulation, including the role of State insurance regulators as the primary supervisors of the business of insurance, end quote.

Going forward, the goal of any agreement we look to enter into should ensure that our system, our State-based model, should be recognized. While it provides me some solace of the new Administration, it looks like it is going in the right direction and upholding our State-based regulatory system, I believe we must pass legislation to make sure that FIO's primary focus is on international agreements.

We know that administrations change and with them the priorities of the Treasury Department. I hope to hear from our panel today and have a focused conversation on what is the role of FIO, what is the future of FIO, and what is the role of the Congress in regard to agreements that are cut by FIO. With that, my time has concluded.

And I now recognize the gentleman from Washington, Mr. Heck, for 1 minute.

Mr. HECK. Thank you, Chairman Duffy and Ranking Member Cleaver for allowing me to participate today. And I want to thank the witnesses as well for providing commentary on these bills that, frankly, Chairman Duffy and I have been working on for the better part of a year.

I don't claim to be an expert on insurance. I am not even on this subcommittee, but I have been active on insurance issues lately because I believe in one thing: State-based regulation works, and it should be protected.

Chairman DUFFY. Mr. Heck?

Mr. HECK. There will always be a temptation in this town—

Chairman DUFFY. Mr. Heck?

Mr. HECK. Yes.

Chairman DUFFY. I am sorry to interrupt you, but I need to ask for unanimous consent to allow your participation in today's hearing to follow our rules. I—

Mr. HECK. Right in the middle of my eloquence?

Chairman DUFFY. Yes, I apologize.

Any objection?

Mr. HECK. Can my time start over then?

Chairman DUFFY. Without hearing any, I would love to give you your full minute back to continue with this brilliance. With that, Mr. Heck, I apologize for interrupting you and continue your recognition.

Mr. HECK. Thank you, Mr. Chair, and thanks again for allowing me to be here today, and thank you again to the witnesses. It is pretty simple. I think State-based regulation works. And I think that this town is always going to want to move in the other direction organically to seek to accumulate its regulatory reach, but it doesn't always work.

We have seen this in securities in cases. We have seen it in banking, and, frankly, I think we see it with insurance. I have also seen the opposite side because I had the privilege to serve in the State legislature many years ago.

And when I was there, truth in packaging, I had the privilege to sit on the floor in my first term next to another young legislator named Mike Kreidler, who went on to be a Member of Congress and, for the last 13 years, has been insurance commissioner of Washington State.

I support State-based regulation because it works. I think it is the best way to provide the best business environment, the best way to protect consumers.

And I think for those reasons we should live up to the spirit of the McCarran-Ferguson Act, some now 75, 80 years later. This is the way to have a healthy insurance market and to protect insurance—and to protect consumers.

And with that, I yield back the balance of my time, and I thank you again, Mr. Chairman.

Chairman DUFFY. Thank you, Mr. Heck.

The chair now recognizes the vice chair of this subcommittee, the gentleman from Florida, Mr. Ross, for 2 minutes.

Mr. ROSS. Thank you, Chairman, and thank you for holding this very crucial hearing. I appreciate your bipartisan leadership on this crucial reform effort.

I believe it is important to think about the context of this hearing. Insurance is ultimately about how we, as a Nation, manage risk. America is a country steeped in tradition of risk-taking, from the explorers who sailed across the ocean to the pilgrims who sought religious freedom, to the pioneers who expanded outward.

We have, time and again, discovered that there exists a balance between risk and reward. We see it with businesses. We see it with athletes. We even see it with scientists.

But not all risk needs to be perilous. That is why we have insurance. With insurance, you can manage risk ensuring that your worst-case scenario isn't actually the very worst case. Such smart risk-taking is a very American idea, and that is why it is so important that the rules of the road for insurance are clear.

Stability and certainty in the legal environment means ensuring that people can innovate and live their lives with confidence. Unfortunately, things are clear as mud.

FIO has uncertain mandate. Different administrators can interpret FIO's role differently. That introduces harmful instability into the insurance marketplace when the whole point is to keep things stable.

The chairman's FIO Reform Act and International Insurance Standards Acts would go a long way toward addressing existing uncertainties and providing the much-needed stability that has been compromised in recent years.

The U.S. insurance market is the single largest and most vibrant of any nation in the world. Our market is strongly regulated by the States putting an emphasis on the protection of the policyholders.

I support this system as it has existed for over 150 years, and believe it is imperative that we expand upon the success of this current model. I look forward to the testimony of our witnesses.

And I yield back the balance of our time.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes ranking member of this subcommittee, the gentleman from Missouri, Mr. Cleaver for 4 minutes.

Mr. CLEAVER. Chairman Duffy, member of the subcommittee, witnesses, good morning. I would like to begin by thanking the witnesses, particularly Mr. Rick Means from Shelter Insurance in Columbia, Missouri, for their testimony.

Today's hearing will give us another opportunity to discuss the Federal Government's role in the insurance industry. As I have mentioned many times in this committee, I support our State-based insurance system and will continue to do so.

However, I believe it is critical that the Federal Government play the role with which it has been tasked through the Dodd-Frank Act and continue to serve as a part of the team USA's voice in the international conversation.

Following the financial crash of 2008, the passage of the Dodd-Frank created the Federal Insurance Office and tasked it with coordinating Federal efforts and developing Federal policy on prudential aspects of international insurance matters, including representing the United States in IAIS (International Association of Insurance Supervisors).

FIO, along with the National Association of Insurance Commissioners and the Federal Reserve, have been serving as the U.S. representatives to the IAIS. It is important to note that no standard, absolutely no standard, agreed to with the international world is binding on the U.S. unless adopted domestically.

This past September, the Trump Administration signed the covered agreement that had been negotiated with the E.U. prior to the end of President Obama's term. The signed covered agreement will allow U.S. reinsurance companies to be able to continue to operate in the E.U. without costly new obligations.

Additionally, the covered agreement recognized the U.S. State-based system in an international agreement—an important win for our unique insurance system. I believe that the agreement will provide certainty for our insurance system, enhance consumer protection, and allow U.S. insurance companies to compete in the E.U. market.

I look forward to hearing from the witnesses, and the coming dialog with my colleagues on the other side.

Thank you, Mr. Chairman.

Chairman DUFFY. The gentleman yields back.

We now welcome our witnesses. Our first witness is Mr. Paul Ehlert, President of Germania Insurance. Welcome. Our second witness is Mr. Schwarcz, a law professor at the University of Minnesota, which I know well 'cause I was a Mitchell grad, so welcome.

And for the introduction of Mr. Means, I want to look to the Chairman of Financial Institutions, the former subcommittee chairman of this committee, Mr. Luetkemeyer, for your introduction. Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I am pleased to introduce Rick Means, the President, CEO, and Vice Chairman of Shelter Insurance based in Columbia, Missouri. A University of Missouri graduate and civic leader, Rick has been a part of the Shelter team for more than 35 years, has vast experience in insurance working in a variety of capacities for his company.

Shelter is one of my area's largest employers and has grown its business to cover policyholders in more than 17 States. Rick, thank you for taking time to travel to Washington to share your ideas with us today.

I am sure the ranking member, as he has already mentioned, would agree it is always good to have some Missourians here. We can hear some stuff from the Show-Me State.

With that, Mr. Chairman, I yield back.

Chairman DUFFY. The gentleman yields back.

Mr. Means, you look too young to have that kind of a lengthy record but welcome.

And we also, for our fourth witness, recognize Ms. Wade, the Commissioner for the Connecticut Insurance Department, testifying on behalf of the National Association of Insurance Commissioners. To all of you, welcome.

The witnesses will, in a moment, be recognized for 5 minutes to give an oral presentation of their testimony. Without objection, the witnesses' written statements will be made part of the record following their oral remarks. Once the witnesses have finished their presentation, each member of the subcommittee will have 5 minutes within which to ask all of you questions.

You will note that on your table there are three lights. Green means go; yellow means you have 1 minute left; and red means your time is up. The microphones are sensitive, so please make sure you are speaking directly into them.

And with that, Mr. Ehlert, I now recognize you for 5 minutes for your oral presentation.

STATEMENT OF PAUL EHLERT

Mr. EHLERT. Good morning, Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee. Thank you for holding this important hearing. My name is Paul Ehlert, and I am President and CEO of the Germania Insurance Companies out of Brenham, Texas.

Germania began in 1896 with 31 farmers in rural Texas, a grange to insure each other, and has grown to a group of companies writing $500 million in personal lines premium and insuring over 200,000 families across our State. Being a mutual insurance company, Germania exists solely for the benefit of our member policyholders.

I do want to start by saying I appreciate the subcommittee's focus on the proper role of the Federal Government in insurance regulation. Germania strongly supports the State-based system of regulation in the United States and is opposed to duplicative and onerous Federal involvement.

The national system of State regulation has, for more than a century, served consumers and insurers well. Any Federal regulatory authority, whether designed to replace or duplicate this system, would disrupt well-functioning markets, introduce competitive inequities, and generate confusion among consumers.

Unfortunately since the passage of Dodd-Frank in 2010, we have seen a growing level of insurance-related activity in Washington. And we would urge Congress to consider ways to reverse this trend.

Two bipartisan bills recently introduced under Chairman Duffy's leadership would work to accomplish this goal, and Germania strongly supports them both.

First, H.R. 3861, The Federal Insurance Office Reform Act, recently introduced by Chairman Duffy and Representative Heck, would properly refocus the FIO and bring its activities more in line with the original intention for the office.

Dodd-Frank established the FIO to provide expertise and information on the insurance industry to lawmakers. It was not given regulatory authority, but was provided some authorities that have created unnecessary duplication.

I believe that the vast majority of U.S.-domiciled property and casualty insurance companies, including Germania, would be in favor of eliminating the FIO entirely.

We view the FIO as unnecessary. It performs many redundant functions better left to the States, needlessly utilizes administrative capabilities, and does not provide public benefits to justify its cost.

That said, H.R. 3861 will be a major step toward returning the office to its intended purpose. The bill is designed to keep the mission focused on coordinating Federal efforts abroad and defending the U.S. market, insurers, and policyholders, rather than attempting to regulate the insurance industry here at home.

The bill would also cap the number of employees, limit the office's subpoena authority, explicitly prohibit the FIO from participating in regulatory supervisory activities, and require more consultation between the FIO and the functional State regulators. We believe all of these changes would be valuable.

Second, H.R. 3762, The International Insurance Standards Act, would help bring needed oversight to recent efforts to create international regulatory standards for insurance companies.

Since the financial crisis, the G–20's Financial Stability Board and the International Association of Insurance Supervisors have become increasingly engaged in prescriptive standard-setting for insurers.

To date, we have heard no real justification of the need for these types of one-size-fits-all standards. And we should be skeptical of global regulatory uniformity for uniformity's sake.

We need our country's officials that engage in these international conversations to speak in defense of the U.S. market, our existing regulatory structure, insurers, and especially our policyholders.

In addition to increasing the transparency at international insurance standard-setting bodies, H.R. 3762 would prohibit those officials from agreeing to new international standards which do not comport with existing State and Federal law.

The legislation would also provide a process by which Congress could vote on a resolution of disapproval for any standard or covered agreement that Federal officials negotiate.

Germania believes that these steps would help to insure that foreign regulatory standards inappropriate for our system and markets would not be unilaterally imported to the U.S. and would provide Congress the ability to exercise its proper role in the process.

Germania believes that both of these bills should be a part of any effort to right-size the Federal role in insurance regulation. And we urge swift consideration and passage by this committee.

Again, thank you for the opportunity to speak here today, and I forward to any questions you may have.

[The prepared statement of Mr. Ehlert can be found on page 40 of the Appendix.]

Chairman DUFFY. Thank you, Mr. Ehlert.

The chair now recognizes Mr.—Mr. Schwarcz for 5 minutes.

STATEMENT OF DANIEL SCHWARCZ

Mr. SCHWARCZ. Thank you, Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee.

In my remarks today I want to make three major points. The first is that the FIO does in fact serve a very important purpose in monitoring State insurance regulation. It is important to realize that FIO does not have any regulatory authority. Its primary mandate is actually to monitor and to assess the State-based insurance regulatory system.

We hear a lot about how strong the State-based insurance regulatory system is, but little context as to why. Historically, virtually every single major advance in State insurance regulation was a result of direct Federal pressure.

If you look at risk-based capital requirements, if you look at guaranty funds, if you look at the accreditation system, if you look at market—speed to market reforms, every single one of those reforms was driven by the threat of Federal preemption and Federal scrutiny.

So what we can first learn is that the State-based system of regulation is strong because the Federal Government has played a consistent role in monitoring and overseeing that system. But unfortunately, Federal scrutiny has basically arisen when there has been a scandal or when the insurance industry has lobbied for reform.

We haven't, before Dodd-Frank, had a systematic way to actually ensure that State-based regulatory issues that are problematic are dealt with and monitored and rise to the level of Federal scrutiny before they become scandals or before they trigger a tremendous amount of scrutiny from the industry.

What FIO does is systematize Federal scrutiny. It allows an office to say there are problems and to have a dialog with State insurance regulators. That is appropriate and it is consistent with the State-based system and why the State-based system is as strong as it is.

The second major point I want to make sure to emphasize is that the Federal Government does indeed have a role to make sure that there is not systemic risk in the insurance market. Systemic risk issues are different than protecting policyholders, and it is unbelievable to me that we are not even mentioning AIG (American International Group) up to this point in this committee hearing.

AIG was an insurance. AIG caused tremendous externalities to the entire financial marketplace because of its failure. And so what we know from AIG, and what we know frankly from pretty much every angle in the academic realm, is that insurance companies can become systemically risky. They can indeed impart tremendous harms on the rest of the economy, and we can't simply ignore that risk.

As a result, this Federal system has a role to play in making sure that insurers don't take on too much risk. Why? Because frankly States are limited in this capacity.

While States do a great job at regulating solvency, they do not have a role to play, and they certainly don't exercise the role well in my view, in regulating for systemic risk.

Why? Well most State insurance regulation is focused on individual insurance companies. It is not focused on the aggregate company as a whole. And that is problematic because if you are going to regulate a company on the basis of the concern that it might actually have broader costs for the financial system as a whole, you need to regulate that company as a whole.

That is what we do when we designate firms as systemically significant via FSOC (Financial Stability Oversight Council) and we impose upon them consolidated supervision and prudential oversight. And that is entirely appropriate.

Third, the Federal Government has a major role to play in coordinating international negotiations for two reasons. First, the Federal Government can coordinate disparate States and send a unified message.

It also has unique clout in the Federal environment because, frankly, the Federal Government is usually the voice of the United States in the international arena and that is what international actors expect. But moreover, systemic risk is an important issue in the international arena precisely because it can't be cabined by national or international borders.

As a result, the Federal Government does have a role to play there and that role should not be undermined by, for instance, requiring FIO to achieve consensus among the States. Frankly, most of the time, there are different views amongst the States so that standard in completely unrealistic.

And it should also not be cabined by preventing FIO from negotiating advances in international standards. As Mr. Cleaver mentioned, international standards are not law. If they are problematic, if they are not accepted domestically we do not have to import them into our domestic law.

So for those reasons I do believe the Federal Government has an important role to play in the international insurance realm. Thank you.

[The prepared statement of Mr. Schwarcz can be found on page 56 of the Appendix.]

Chairman DUFFY. Thank you, Mr. Schwarcz.

Mr. Means, you are now recognized for your opening statement for 5 minutes.

STATEMENT OF RICK MEANS

Mr. MEANS. Thank you, Chairman Duffy, Ranking Member Cleaver, and the members of the subcommittee for holding this hearing on two important bills that would benefit consumers and the insurance markets.

My name is Rick Means, and I am the President and Chief Executive Officer of the Shelter Insurance Companies. Shelter is a mutual company headquartered in Columbia, Missouri providing auto, property, business, and life insurance in 20 States, as well as provide reinsurance internationally. I am a member of the board of the Property Casualty Insurance Association of America.

Shelter strongly supports H.R. 3861, the Federal Insurance Office Reform Act of 2017, and H.R. 3762, the International Insurance Standards Act of 2017.

The business of insurance is and should be regulated at the State level. While no regulatory system is perfect, State insurance regulations have effectively protected consumers for 150 years and with a much stronger record of preventing failures and protecting consumers than most Federal regulators.

State regulators already have over 11,000 staff supervising insurers. We don't need a second layer of Federal bureaucracy. State regulation, which helps to keep our insurance industry solvent, is relatively uniform, while consumer protections are tailored according to State law to protect local community businesses and families.

Congress and the Administration considered Federal insurance regulation during the Dodd-Frank Act deliberations, but ultimately left McCarran-Ferguson largely intact in favor of State insurance regulation.

One gap in State regulation that Congress recognized was a lack of a spokesman to represent the Federal Government internationally. The Federal Insurance Office was created in large part to fill this role.

But FIO is not a regulator. While the Federal Reserve Board or the SEC (Securities Exchange Commission) are the primary regulators for banking or security standards, for insurance the States are the primary regulators. The States would ultimately have to implement any international standards, not FIO.

And yet it has never been clear on whose behalf FIO is negotiating. Certainly not on behalf of the State regulators who are often in conflict with FIO.

In fact, FIO is under the direction of the Treasury Department, which historically has had a banking dominated perspective. The Treasury Department previously opposed—proposed to eliminate State insurance regulation, both immediately, prior to, and during the Dodd-Frank Act negotiations. So it stands to reason that Treasury has not been willing to closely coordinate with those same State regulators.

For example, the International Association of Insurance Supervisors used to hold most of its meetings open to public participants. FIO voted with foreign regulators, over the strong objections of the U.S. State insurance regulators, to close those meetings to the public.

The vast majority of international insurance meetings are now held behind closed doors without accountability. I have included a chart showing the scope of these meetings potentially affecting all corners of the regulatory system.

FIO has also refused to coordinate with States in advance of critical international negotiations and even ran against U.S. State regulators for international leadership positions. This degrades U.S. credibility and undermines our international strength. It is not what Congress intended and must be fixed.

Instead of focusing on developing strong team USA positions, FIO has spent—spent considerable resources second guessing the States on their core activities and threatening State regulators with Federal intrusion.

FIO has imposed multiple data calls on insurers on subjects well within State authority, such as auto insurance and terrorism insurance. The State regulators on multiple occasions offered to coordinate data calls to avoid duplication and conflict. Instead they both issued data calls creating cost and burdens for us as insurers, with little benefit, as FIO's mission creep continually expanded.

The Duffy and Heck bills would move FIO to the Treasury's international division and eliminate FIO's regulatory subpoena power, which was never appropriate given that it is a non-regulator. And it would help to end unnecessary data calls.

We need FIO and the States working together, not in conflict, and we need FIO to focus on its international mission. With appropriate safeguards and appropriate supervision by Congress, the Duffy-Heck bills would focus—would focus FIO toward that end.

I want to stress that the FIO staff has recently made great efforts to repair relations with the States and refocus their efforts and should be commended for those—for these improvements.

But Congress should take this opportunity prior to these changes and to ensure that in the future FIO works with the States and stakeholders and not against us.

Shelter strongly supports the Duffy and Heck bills and urges members of this committee to do the same. Thank you very much.

[The prepared statement of Mr. Means can be found on page 50 of the Appendix.]

Chairman DUFFY. Thank you, Mr. Means.

The chair now recognizes Ms. Wade for an opening statement for 5 minutes.

STATEMENT OF KATHARINE WADE

Ms. WADE. Thank you Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee. I appreciate the opportunity to testify today regarding the appropriate role for FIO and the need for additional oversight on the Federal Government's engagement on international insurance issues.

Specifically I offer the NAIC's (National Association of Insurance Commissioners) support for two pieces of legislation under consideration. Chairman Duffy and Congressman Heck, we appreciate your leadership and support for State-based insurance regulation.

First, the NAIC supports the International—International Insurance Standards Act. We worked extensively with our international regulator counterparts to develop best practices, but we are always mindful of protecting the interests of our consumers and maintaining stable, competitive insurance markets.

International dialog is important, but we must not allow international policy decisions to drive changes to our domestic regulatory framework that could potentially disadvantage or undermine the stability of the U.S. insurance sector.

The U.S. insurance market is the largest and most competitive in the world. Nearly 6,000 insurers write $2 trillion in annual premium and employ 2.2 million people. State insurance regulators supervise more than one-third of all global premium, and taken individually, U.S. States make up 26 of the world's 50 largest insurance markets.

State insurance regulators are committed to working with our Federal colleagues, the Federal Reserve and FIO, as we engage internationally. However, it is important to understand that their authorities in the insurance sector are more limited than those of the States, the primary insurance regulators.

The Fed regulates depository institution holding companies with insurance operations and any insurers designated by the Financial Stability Oversight Council.

In the same vein, FIO has no regulatory or supervisory authorities, but we recognize that the Treasury Department has an interest in financial stability and the health of our national economy generally.

Therefore, while we—while it is critically important that we all work together internationally as part of team USA, we must do so with appropriate recognition of our respective domestic authorities.

While there has been a noticeable and welcomed improvement in the relationship and coordination with FIO, this has not always been the case.

For the last 6 years, FIO's involvement in international regulatory standard-setting has made it more difficult for U.S. regulators to defend our domestic regulatory framework. The standards at the IAIS continue to reflect a largely European approach to supervision, and in certain fundamental aspects would not be compatible with the U.S. system.

Furthermore, FIO is not a regulator and does not represent insurance regulators so its significant involvement in regulatory standard-setting, has up until recently, led to a disconnect between our domestic regulatory direction and the international agenda.

Likewise, the Fed has had an outsized role in insurance regulatory standard-setting, particularly in light of its limited insurance regulatory role. Moreover, despite significant efforts to work with our Federal counterparts on international matters, we have been disappointed with their unwillingness to include us in international discussions in other forums, like the FSB.

Given our past experience, we believe it is appropriate for Congress to provide additional oversight of the Federal Government's engagement on international insurance issues.

The International Insurance Standard Act addresses many of our long-standing concerns. It requires Federal Government representatives to include insurance regulators in any insurance discussions and defend the U.S. system of regulation, the will of Congress and the States. It also enhances transparency of any international agreements and approves congressional oversight.

Second, the NAIC supports the Federal Insurance Office Reform Act. This legislation is a positive step toward refocusing FIO in areas where it can provide the most value to the Federal Government and tailoring its size to fit those needs.

It makes clear FIO represents the Treasury Department and is responsible for coordinating Federal international insurance policymaking. Under a key provision, FIO must consult and reach consensus with State insurance regulators on international matters.

This is critically important in standard setting where it is most appropriate to defer to the States as the primary regulators of the sector.

The proposal limits the size of FIO and refocuses it on its highest and best use, a policy office within the Treasury Department and a voice for the Federal Government on international insurance matters.

In conclusion, we support these two pieces of legislation. They encourage deference to our insurance regulatory system, support greater Federal–State cooperation, promote transparency, and provide more clarity to Federal agencies regarding their role with respect to the insurance sector, ultimately resulting in better outcomes for the U.S., our companies, and our citizens.

Thank you for the opportunity to testify today. I look forward to your questions.

[The prepared statement of Ms. Wade can be found on page 83 of the Appendix.]

Chairman DUFFY. Thank you, Ms. Wade.

The chair now recognizes himself for 5 minutes for questioning. I just first want to go to the concept of our State-based insurance model. Does anyone think we should cash that in and go to a new or different regulatory model? If you do, say yes.

Mr. Schwarcz, do you want to cash that in, just to be clear on your testimony?

Mr. SCHWARCZ. I think—I think that the current system we have now is a dual system, frankly. I think the Federal Government plays a role, and I think that role is appropriate. I think the Federal Government has always played that role. So I think that is appropriate. That is consistent with State primacy.

Chairman DUFFY. And I wanted to look forward to legislative fixes, but before I do that I do want to take a look back. And Mr. Schwarcz had mentioned AIG.

But maybe I will go to Ms. Wade first. When you look at AIG and the insurance aspect of AIG versus the holding aspect of AIG, did the insurance portion of AIG fail that was supervised by the—this—under our State insurance model? Or did the holding company with financial products fail? Do you know the answer to that?

Ms. WADE. It was the holding company related to the financial products. So the Office of Thrift Supervision was the consolidated regulator for—for AIG at the time. The States had identified this—the securities lending issues and were winding those down.

It was the result of the derivatives, the financial products, that caused a liquidity crisis that resulted in AIG's challenges during the financial crisis.

Chairman DUFFY. So just to repeat again, who was the regulator of the holding company of AIG.?

Ms. WADE. The Office of Thrift Supervision.

Chairman DUFFY. Now, are they a State insurance regulator?

Ms. WADE. No, and in fact State insurance regulators were preempted from addressing the issues that caused the—

Chairman DUFFY. And so the problems were not on the insurance side that was regulated by the State. Is that correct?

Ms. WADE. Correct.

Chairman DUFFY. So to use that as an example of why the State-based model doesn't work, really isn't accurate is it?

Ms. WADE. No, it is not.

Chairman DUFFY. And if you look at the 100 year plus history of the State-based model, would you argue that it has worked, actually, fairly well?

Ms. WADE. Yes, it has. It has worked very effectively for 150 years.

Chairman DUFFY. I would agree with you. And so I want to move, and Ms. Wade, I want to focus on you for a moment. You have had a lot of dealings in your role as we have gone through the covered agreement process. What are your thoughts on how that process actually worked on the first covered agreement?

Ms. WADE. So we appreciate the clarifications that the Administration has given because we had some concerns with a covered agreement because of the ambiguity of the language.

The covered agreement addressed a very specific situation. But we believe that the U.S. statement of position that we will not be adopting Solvency II in the United States, the recognition from the European Union of the capital calculation, not the capital standard that the U.S. is developing.

We are developing a capital standard to look at across group—across the groups. And we believe that after the covered agreement was brought forward, States were able to—56 of us were able to get together and come up with a position on how we felt about the covered agreement.

Chairman DUFFY. In regard to the process of coming up with an agreement, how was the cooperation and collaboration and information flow from FIO to State commissioners?

Ms. WADE. So the commissioners that participated were not able to talk to the other regulators—other State regulators to talk to them about the issues involved. They were given access to some information and they were allowed in some of the meetings but not all of the meetings.

Chairman DUFFY. And so do you think there is room for improvement?

Ms. WADE. Yes, absolutely, there is room for improvement and that is why we support the legislation.

Chairman DUFFY. Thank you. If we look at how the U.S. Government implemented the covered agreement versus the E.U., the European Union actually had a vote on the covered agreement where we in Congress did not have a vote.

Mr. Ehlert, do you believe that the Congress should have a role in approving or disapproving covered agreements?

Mr. EHLERT. Definitely, Chairman Duffy. I don't think Congress would want to abdicate the lawmaking ability, both—both at a Federal or a State level to some international regulatory bodies.

Chairman DUFFY. It is fair to say that this has a huge impact on all of our States. And if you outsource it for an FIO to cut an agreement without our approval, we are disenfranchising the very people who elected us to represent them.

This is, I think, an affront to our representative democracy when you have rulemaking through the legislative process or a—or a covered agreement process that doesn't include the Congress. With that my time has expired.

I now recognize the ranking member, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. Two months ago the President signed a covered agreement. And on the day that he signed that agreement, the Secretary of Treasury Steven Mnuchin was quoted as saying, and I quote, After extensive stakeholder engagement and review, Treasury has concluded that the covered agreement with the E.U. is a win for the United States, the insurance industry and U.S. policyholders.

Mr. Schwarcz, do you embrace the words of the secretary?

Mr. SCHWARCZ. I agree, and I think that there are different types of international agreements, but there are plenty of scenarios in which the executive branch is authorized to enter into foreign agreements without congressional approval.

So I don't think that it is a bit of hyperbole to call that an affront to our representative democracy. And just if I may, I just want to briefly respond to one other thing that the—Chairman Duffy said.

In my view it is incorrect. It is a narrative that State insurance regulators have pushed that they are not at fault at all for AIG's failure.

AIG's failure was absolutely just as much a product of its securities lending operations at its—as its default operations. It would not have failed were it not for the fact that it had lent out the assets of its insurance companies to other entities, taken that money and invested it in mortgage-backed securities.

Moreover, it is absolutely incorrect to say that State insurance regulators were on top of it. This is just a quotation from the U.S. Government Accountability Office, a nonpartisan office as far as I understand, "Prior to mid–2007, State regulators had not identified losses in the securities lending program. And the lead life insurance regulator had reviewed the program without major concerns." OK. So this narrative that State insurance regulators weren't at fault is wrong.

Now, I admit Federal regulators also had a role to play in AIG's failure. The Office of Thrift Supervision did not execute its duties responsibly.

That is why we reformed the system and got rid of the Office of Thrift Supervision. But we also need to take a look at the failures of State insurance regulators in the context of AIG.

Mr. CLEAVER. Yes, just—just for the record again, at every committee hearing I have participated in over the years on—on this subject I have talked about my irreversible commitment to continue the State regulatory system in the—in the country.

I would like to get to Mr. Means, and you too, Professor Schwarcz, do you believe that the FIO actually plays an important role and what would happen if it disappeared?

Mr. MEANS. Thank you, Mr. Cleaver. Yes, I think FIO has a—has a position, has a place, but it needs to make sure it stays out of State regulation and it works to be the face of the insurance business internationally.

That it gets input in the NAIC, from State regulators, to make sure that whatever position they are taking internationally is supported by what the—what the States and—want to see them do. So I think there is—there is a place there for—for FIO, as long as it includes getting input from Congress, getting input from the States and represent us—represents us internationally.

Mr. CLEAVER. Professor?

Mr. SCHWARCZ. I absolutely think FIO has an important role. As I mentioned in my testimony, and it is elaborated on my written testimony, if you look at the State-based insurance system every single major advance in that system was a result of failure, Federal scrutiny, and then reform at the State-based level.

A system works well when it is being monitored and scrutinized. And that is the role of FIO. It is not a regulator. All it does it scrutinize and monitor the system.

And it is simply inconceivable to me that we would talk about the strengths of the State-based system without acknowledging the history the Federal Government has role—has played in scrutinizing it and making that scrutiny systematic and prevent—and making sure it happens before there is a crisis or before there is active efforts to—to lobby is smart.

Mr. CLEAVER. Mr. Means, Missouri lost Monday night to K.U., something has to happen. Thank you.

Mr. MEANS. I would agree. I wished I had some input into that, but it was a close game and everybody played hard. So we are looking forward to a good season.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the vice chair of this subcommittee, the gentleman from Florida, Mr. Ross, for 5 minutes.

Mr. ROSS. Thank you Chairman. And I want to thank our panelists for being here today, too. Look, as a strong proponent of the State-based system, I think it is a tremendous example of States' rights and something that has worked significantly well.

And Ms. Wade, especially as a regulator, I think that you can attest to the fact that State-based systems have had a strong track record in terms of solvency. And— could you just elaborate a little bit on why?

Ms. WADE. Sure. So since the financial crisis, the States had made a number of improvements in our financial solvency modernization initiative. So we have taken a number of steps forward in terms of having companies put together an own risk and solvency assessment. It is called an ORSA, where they look at their entire group of insurance and non-insurance entities.

Talk about the risk, how they are addressing the risk, and where they are in the continuum of solving the risk. We have done a lot of initiatives in terms of corporate governance disclosure. And it—

Mr. ROSS. And—and risks are heterogeneous—

Ms. WADE. Yes.

Mr. ROSS —across this country. I mean, the risks in Florida are different than the risks in Connecticut or California or somewhere else. So it requires that local, if you will, State perspective on assessing those risks, also in terms of solvency, also in terms of consumer protections.

Now, Professor Schwarcz would suggest, however, that there is a greater degree of purity at a Federal level that would allow for the States to be monitored because apparently State regulators and State legislatures who are behind their certificates of authority that give these insurance companies that opportunity just can't monitor sufficiently.

In other words, you all don't have it right on fraud, waste, and abuse. You all don't have it right on consumer protections. And if it wasn't for the white horse of the Federal Government, you all might not be needed in this market.

How do you respond to that when we have a process that has worked for 150 years, probably better than any other regulatory scheme this Nation has seen?

Ms. WADE. We work very hard to look at what we do every day. Our job, first and foremost, is consumer protection. And we look at our system and we adapt to—we see things coming in the future. We—we address those issues. We are accountable to Governors and State legislatures for what we do.

And we are—

Mr. ROSS. And—and you are accountable to consumers, to policyholders. And can you imagine the IAIS, not only imposing different capital standards, but also different consumer protection standards? Is that not a possibility?

Ms. WADE. That is a possibility.

Mr. ROSS. And should we not have somebody at the table with insurance experience and a regulatory scheme at the table with the IAIS, instead of somebody in a regulatory scheme for the Federal Government?

Ms. WADE. It is very important to have legislators—have regulators that work day to day in regulating the U.S. insurance markets at the table to explain how the system works. Our system is different than—than the European systems and others. And it is very important that State regulators are at the table having those conversations.

Mr. ROSS. Thank you.

Mr. Means and Mr. Ehlert, real quickly, what is the true impact here in terms of consumer protections, in terms of the products for the consumers? If we are talking about increased capital standards, if we are talking about greater regulatory burdens and compliance on behalf of domestic insurance companies, does that not go against what you have a fiduciary responsibility to to your mutual members?

Mr. EHLERT. Are you directing that question to me?

Mr. ROSS. Yes, sir.

Mr. EHLERT. Yes, we do. Being a mutual insurance company, our members are the owners of our insurance company.

Mr. ROSS. Correct.

Mr. EHLERT. Any costs that we incur that is unnecessary is just added to our premiums that our insurers have to—

Mr. ROSS. Also compliance. The number one job in the country today is a compliance officer. Isn't that a shame?

And Mr. Schwarcz, professor, you are a professor of law, and God bless you because I am a student of the law, you have to believe in due process.

And if you believe in due process than why not—if we are going to have SIFI (systemically important financial institutions) designations, which I think MetLife was pretty successful in showing that they didn't need to be, and when in fact the only person on FSOC who has insurance background who served as an insurance commissioner said do not designate them.

They designated them and the courts can go back and say hey, you know what? You shouldn't have designated them. But if you are going to designate a non-bank financial institution as a SIFI, would you not agree as a lawyer that they should have due process?

One, they should be put on notice that they are being investigated; two, you have an opportunity to correct that; and three, once you get a chance to correct that, there is a period of time by which you will be reassessed. But that doesn't exist today, does it today, professor?

Mr. SCHWARZ. Actually, that is not correct. It—they were—

Mr. ROSS. No, there is no due process—

Mr. SCHWARZ. Yes, it—

Mr. ROSS —as a SIFI—

Mr. SCHWARZ. Well, do you want me to respond?

Mr. ROSS —designation.

Mr. SCHWARZ. Or no?

Mr. ROSS. Go right ahead.

Mr. SCHWARZ. That is not correct. They were told at stage three that they were being—

Mr. ROSS. At stage three.

Mr. SCHWARZ. At stage three.

Mr. ROSS. Where was stage one?

Mr. SCHWARZ. They were allowed—

Mr. ROSS. How did they know about that?

Mr. SCHWARZ. They were allowed at that time to—to meet multiple times with FSOC staff. They presented their case. They had multiple meetings, and, at the end of the day, they were designated.

One other thing, I believe you mischaracterized my testimony. I never said that the Federal Government should have a role in consumer protection. I said that the Federal Government should have—

Mr. ROSS. Should monitor—

Mr. SCHWARZ —a role with respect—

Mr. ROSS. Should monitor.

Mr. SCHWARZ. To monitor.

Mr. ROSS. Does that not be—

Mr. SCHWARZ. Absolutely.

Mr. ROSS —is that not a broad brush as to what the insurance industry is allowed to—

Mr. SCHWARZ. So you don't want to monitor State insurance regulation? I thought that—

Mr. ROSS. I think we do monitor well, and I think Mrs. Wade has—has testified to that, as have all the other 50 States who have done very well in protecting their consumers.

And I yield back.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the ranking member of the full committee, the gentlelady from California, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much. Mr. Schwarcz, I think you have done an excellent job of describing what you think a relationship might be. For those members on the opposite side of the aisle, we are trying to change history about AIG and trying to imply that somehow you want the Federal Government to take over all State insurance.

Take this time and continue to straighten them out. The floor is yours.

Mr. SCHWARCZ. Thank you very much. It is well-recognized with respect to AIG that there were two major problems. There were problems with its credit defaults swaps and there were problem—problems with its securities lending operations.

And the problems, as I mentioned, with the securities lending operations we are—were not caught in time by State insurance regulators. That is the conclusion of the—of the GAO, not just my conclusion.

Moreover, what is really important to understand here is the reason those two problems were catastrophic for AIG is because they both worked in exactly the same direction, but from different points in the company.

Credit default swaps was basically insurance on mortgage-backed securities. Securities lending was essentially a way to invest in mortgage-backed securities.

In order to appropriately appreciate the risk that exists there, you need to take a holistic perspective on the company and understand that they are taking major risks in the exact same way across disparate elements of the company.

State insurance regulators are not well-equipped to do that because they focus predominantly on individual insurance entities. They do not focus holistically.

So when I say that there is a role for the Federal Government to play, it is not to take over consumer protection. It is not to undermine the State-based system, but it is to supplement the State-based system when it is necessary. And I think that is really what has happened.

The other thing I would just note with respect to that is that the Federal Government has actually done, I think, a pretty good job at monitoring the State insurance regulatory system over the last 5, 6, or 7 years.

And if you look at many of the changes the State insurance regulators have made over the last 7 years, there is no doubt that a part of the reason why they made those changes was because FIO was suggesting them and encouraging them to do it.

No system is perfect. Every system should be scrutinized. The State-based system, look, it works very well on a wide range of topics, but that doesn't mean that there shouldn't be systematic scrutiny at the Federal level.

The idea that this is draining resources is, again, it is ludicrous. I mean we are talking about a dozen people in the Treasury Department who are writing reports. I have no idea how that undermines the State-based system or imposes costs on policyholders.

The one area where FIO does have an authority is to—is to ask—is to get data when it is necessary to monitor the system. And they almost never use that authority, but when they do it it is because the States are refusing to do so.

And I know that on a topic that is quite important to you, Congresswoman Walters—Waters, with respect to affordability, the State-based system just recently decided you know what? We don't need to get individual insurers' data on affordability, even though there was wide-ranging agreement that was necessary to determine whether particular insurers were playing a role with respect to that issue.

Instead they said, "We are going to go aggregated data." Well, that is an instance where you know what? FIO probably does have a role to play in saying you know what? Let us look at the data and see whether affordability issues that we have identified are, indeed, being caused by certain insurers or certain individual insurance practices.

Ms. WATERS. Thank you very much, and I would like to thank you for mentioning the role that I played in Dodd-Frank that requires the Federal Insurance Office to monitor the affordability and accessibility of insurance to traditionally underserved communities.

I am concerned that this authority will be rendered virtually meaningless if FIO's ability to collect data from the insurance industry is undermined. So that is a role that can be played.

I think that some of my colleagues on the opposite side of the aisle are making too much of what we are talking about in this relationship.

Nobody is talking about taking over. Nobody is talking about denying. We are talking about working together with the international concerns that must be dealt with.

And so I thank you for your testimony here today. I am hopeful that we are wise enough to understand the relationship and how it can be helpful to all of our citizens as we deal with insurance.

So with that, Mr. Chairman, I will yield back the balance of my time.

Chairman DUFFY. The gentlelady yields back.

The chair now recognizes the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman. Thanks to each one of you for being here today. Just trying to summarize for myself what the discussion is about.

We have got State people saying that we do a pretty good job, and we have got some of the largest insurance markets in the world and please don't mess with it. And the other side saying that, well, the Federal Government is here, I guess here to help you.

I think Mr. Schwarcz's comment was that their job is to assist, they are here to assist the State-based system. Some of the scariest words known to my constituents are, "I am from the Federal Government, and I am here to assist you." So I worry about that, and I hope you understand that.

Mr. Schwarcz goes on to say on page seven—Ms. Wade, I will probably direct this to you—"The State insurance regulations as it exists today is fundamentally a product of periodic Federal scrutiny which consistently have proven to be the key catalysts in prompting States."

Is that accurate from your perspective, that the only reason y'all have ever made changes is because somebody from the Federal Government brings it to your attention, and they are the key catalyst?

Ms. WADE. No, I would not say it has been the key catalyst of all changes that have been made in the State-based system. We constantly as—as regulators are looking at how we do our jobs and looking at ways we—that we can improve the system and improve our oversight of insurance entities.

Yes, we have responded to criticism from industry, other stakeholders, as well as from the Federal Government over time, but—but not all changes to the State-based system have been driven by Federal—Federal—the threat of Federal oversight.

And—and if I can respond to Professor Schwarcz related to AIG—

Mr. PEARCE. Fine.

Ms. WADE. It—it is—it—the insurance entity remained solvent. The real issue was the derivatives. And if that—the Federal Government got repaid through the insurance subsidiaries making—making good on the—on the money that it was given by the Federal Government. So—

Mr. PEARCE. Well, let us go ahead and—

Ms. WADE —it has worked.

Mr. PEARCE. Let us go ahead and consider that because, again, the AIG is used as the document here from Mr. Schwarcz. It says that y'all were incapable and it took the oversight of the government to look at that.

And he says that AIG was taking money from customers, basically, and lending it out, which is not a good deal. And the assertion is that the—without the Federal Government no one would have seen that.

Now for me, those same Federal regulators were sitting watching MF Global. They were in the room over the period of weeks while MF Global took $1.8 billion out of customer accounts and tried to—to hold onto their business. And they didn't really say anything.

And so the idea that the Federal regulators are going to be these white horses that bring it to your attention because they are so, so in tune with it, is one that I personally don't believe, but I am willing to listen to it.

I also look at Bernie Madoff. He started his business in 1960 and they didn't finally do anything until 2008. So seven—$68 billion or $65 billion, which is almost the equivalent to the AIG failure—it was about $99 billion—but—so the Federal regulators sat in there watching. And people called and said, "Hey, this guy is scamming us." They couldn't quite get the focal point on it.

And so they decided, yes, that the regulators are going to be there from the Federal Government here to help you and to assist you and you are—the only reason you make a mistake—or the only reason you correct your mistakes is because of that, is one that I find suspiciously directional.

Now, what does all of this mean at the end of the day? I think that Mr. Means maybe you hit that on a back chart here. Is that something that you are familiar with?

Mr. MEANS. Yes.

Mr. PEARCE. That you are eliminated from 80 percent of the discussions—80 percent of the discussions you are not in. That is what I really fear is that we have a Federal Government that can't watch out its own business.

They are going to come down and they are going to claim that they are helping you down here, you poor States can't quite figure this out yourself. We didn't figure out on a Federal Government. Of course, we didn't figure out Madoff, but we are down here.

But the real deal is the 80 percent elimination out of any investigation or any discussions going on internationally in which the State Department States regulators would be bypassed, and therefore the international markets have access to us.

You down on the State level, Mr. Ehlert, are you ever going to compete over in Europe?

Mr. EHLERT. No, sir, I am not.

Mr. PEARCE. Yes. So that is the real deal is that we have got a few big guys that might compete in Europe, but the power and the strength of this State-based economy, this State-based insurance system, is going to be bypassed on the guys that were here to help you and without our help.

You just really haven't done any really good oversight of yourselves, and we bypass all the things that we in the Federal Government haven't done. And at the end of the day, our small people are going to be eliminated out of the market because of regulations and deals made overseas.

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

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentleman from Massachusetts, Mr. Capuano, for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman, and I want to thank the panel. I just—couple of comments. I want to reiterate no one here is suggest—that I am aware of—is suggesting ditching the State-based system. No one here is suggesting that.

To my knowledge, there are no bills to do that. To my knowledge, no member of this committee has suggested that in the past or now. So any statements to the opposite of that are hyperbole. Now, I know you are all new to Congress. We are good at hyperbole, but I—once in a while we have got to cut through that so that there is none of that.

By the way, when it comes to giving up congressional responsibilities—not prerogatives—responsibilities, we do it all the time, fast track authority. We go out of our way to tell the President we don't matter, and we vote for it all the time. Not me, but others do. This Congress does.

When it comes to shooting missiles or deploying U.S. military into foreign countries, we all the time allow presidents, not just one, to do it, and we don't do anything about it. So beware of this whole whoa, it is congressional authority, congressional responsibility. We only want that when we want it. When it gets tough, we don't want it.

So the facts matter to me. I want to talk—oh, by the way, Bernie Madoff committed a crime and went to jail. AIG did not commit a crime. They simply engaged in getting too much risk and diverting it around the country.

That wasn't and still is not criminal. It is bad for the economy, but it is not criminal. Bernie Madoff was a criminal. AIG was just bad for America. So there are differences.

I want to talk specifically about one bill, 3762, and I want to talk about it because I figure it is a fair statement to argue or to discuss what is the appropriate role of the Federal Government, what is the appropriate role of the State? That is a fair question.

And I happen to agree that the State-based system, in general, works very well, but it did miss the AIG system, as did the Federal Government. There is plenty of blame to go around. We are all to blame. Fine. We are trying to fix that.

I also agree the FIO has been too opaque. I totally agree the State-based people should have been brought in from day one, and I had those arguments with the director then.

What do you get to hide? You don't have to agree with everybody, but why not tell everybody this is what we are doing, this is what we are thinking, and this is why, especially since he was from the State system. So trying to find that balance I think is good.

I think 3762 is an attempt to do that. But even then, it doesn't get rid of FIO. It simply says—it states, very clearly, that FIO has to consult with the State systems.

I would like to ask the panelists to find the word "consult" in your definition. Does consult mean they can't do anything unless you agree? Or does consult simply mean that two thoughtful, reasonable, rational adults have to have a discussion before the decision is made?

Mr. Ehlert I would like to start with you.

Mr. EHLERT. Yes. Consulting, in my opinion, means that the two groups are collaborating with each other, explaining their various points and views. But the key to the International Insurance

Standards Reform Act, as you have mentioned, it actually right-sizes the FIO.

None of these two bills eliminate the Federal Insurance Office. They are right-sizing their role that the Federal Government plays in supervising insurance and maintaining the State-based insurance regulatory system.

Mr. CAPUANO. But you do realize there is a way to keep something alive and gut it from the inside, like some of my friends are trying to do to the ACA? They are not trying to repeal it anymore because that is too dangerous. But they are trying to gut it from the inside.

And I agree with you. I don't think these bill—or at least this bill doesn't do that. But to some people's mind—and I want to be clear—that is not the intent.

Mr. EHLERT. Yes. Well, that is—I don't think these bills gut the Federal Insurance Office.

Mr. CAPUANO. I would agree with you.

Mr. EHLERT. I think they right-size what the Federal Insurance Office was originally planned to do, and that was to provide insurance expertise to this—this governing body, to Congress.

Mr. CAPUANO. Mr. Schwarcz?

Mr. SCHWARCZ. So I believe the bill, in addition to using the word consult, requires FIO to get a consensus. Consensus I believe is defined as every single member has to agree. So that means if a single State does not like the position then FIO can't move forward. So I have an objection to the word consensus.

Mr. CAPUANO. I have got to respectfully disagree, Mr. Schwarcz. When the Senate is consulted on various appointments they don't all have to agree.

Mr. SCHWARCZ. No, I know, but the bill I believe has the word consensus in it. So it says it has to consult and then achieve consensus, and so that is my concern, that word.

Mr. CAPUANO. Consensus as defined by whom?

Mr. SCHWARCZ. Well, I believe consensus—I mean, the courts would define it, but I believe—

Mr. CAPUANO. I have reached consensus with my children when I make a final decision.

Mr. SCHWARCZ. Well, I would be OK if you define it that way.

Mr. CAPUANO. My time has expired. Thank you, Mr. Chairman.

Chairman DUFFY. The gentleman's time has expired. I look forward to his endorsement and signature on Duffy-Heck. Thank you for the kind words.

The chair now recognizes the gentleman from Florida, Mr. Posey, for 5 minutes

Mr. POSEY. Thank you very much, Mr. Chairman. Whenever you hear something or whenever I hear something like International Standards Act, antennas go up. And as the President might say, that is when you expect the United States to bend over for everybody else, and so obviously I am sensitive about that.

Other States are even bigger, but my State Florida is the world's 10th largest insurance market. According to the National Association's charts, Florida's is bigger than Canada, Australia, Netherlands, India, Brazil, Spain, Ireland, Switzerland, among many others.

All the States combined, the United States is obviously the biggest market in the world, almost 40 percent. Second place is a little over 8 percent. That is Japan. So the obvious conclusion or observation I would make is maybe we should be moving our standards for the rest of the world, not us conforming with their standards.

I would like your comments, starting with Mr. Ehlert.

Mr. EHLERT. Thank you, Representative Posey. And I believe Texas is the ninth largest insurance market in the world. And the United States insurance industry is five to six times larger than the European Union, yet we are yielding to European regulators to dictate to us what our policy should be.

I do not think that our bodies, our State form of regulation of the insurance industry, which has proven itself through two world wars, a Depression, ruled through 9/11, through Hurricane Harvey, which we are experiencing now, is time-tested and proven.

This body should make sure that our representatives at an international level are negotiating and defending and promoting our U.S. regulatory insurance system. And they should also make sure that any agreements that our Federal Insurance Office were to make would not be in conflict with Federal or State law.

Mr. POSEY. OK. Anyone disagree on the panel?

Mr. SCHWARCZ. Well, I have a different perspective, I guess not surprisingly.

Mr. POSEY. All right.

Mr. SCHWARCZ. My perspective is that it is arrogance for us to way, look, this is the way it is going to be done, and we are just going to ignore you if you want to do it differently.

The way the U.S. should work in the international community is to seek compromise and to seek understanding of different viewpoints. And I think there are good reasons why that promotes financial stability worldwide.

We don't want an AIG coming from another country and destabilizing our system. And we want our insurance companies to be able to operate internationally.

So there are very good reasons to be engaged internationally, and I think that if we go in internationally and say this is the way it is going to be done, we are not going to change our system at all, we are not going to admit any faults, well then we will be ignored by the international community.

And if that happens, international standards will be developed, we will be left out of the room, and eventually we may have to implement them when we had no role in playing in their developments.

So I think we need to be engaged.

Mr. POSEY. Yes.

Mr. SCHWARCZ. And I think we need to be engaged in a way that is constructive and that recognizes even though our State-based system is strong, there are indeed some limitations and some ways in which it can be made better. And I think that that is perfectly consistent with being a defender of State-based regulation.

Mr. POSEY. Well, I certainly wouldn't want to be politically incorrect and get stuck with 40 percent of the world's market.

Actually I think we are in a pretty enviable position and as the President has talked about many times in the trade agreements, every time we get into an international agreement, it seems like we get the short end of it at the end of the day.

And so I hope we don't go there. I just can't believe the United States needs to construct a one-size-fits-all regulatory standard representing some kind of a compromise in the way other jurisdictions operate. It is just hard to believe that that would be in our best interest.

Does the Office of International Federal Insurance strengthen or reduce the ability of the United States to achieve good incomes—outcomes, I am sorry, in international standard-setting and trade discussions?

And we will go back to Mr. Ehlert again.

Mr. EHLERT. I believe the question was does the Federal Insurance Office strengthen the international negotiation process for international capital standards?

Mr. POSEY. That is the question.

Mr. EHLERT. The Federal Insurance Office in the past was taking positions on the international capital standard that was adverse to our State regulators.

So to answer your question, I would say no because of the lack of coordination and collaboration that Ms. Wade described in her opening statement would reflect that the FIO was out there trying to do it on their own.

Mr. POSEY. OK. Mr. Means?

Mr. MEANS. Oh, I agree totally. I have nothing to add to that. I think he is absolutely right.

Mr. POSEY. Thank you, Mr. Chairman.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. I would point out that the insurance market in California is roughly comparable to that of the United Kingdom or China, and why California is deprived of its own seat at the table is something we should discuss. Though I would—but what we see here over the last 50 years is more and more power in the executive branch of the Federal Government.

The bill before us, one of the two bills, says that Congress will have an opportunity to disapprove any agreement that is reached.

Professor Schwarcz, any reason Congress shouldn't have a formal way to disapprove the agreement?

Mr. SCHWARCZ. No, I don't have any. I don't think it is a problem, if that is what Congress wants to do. I do think it is a problem if there are procedures that require reporting as the negotiation is moving forward, because that undermines negotiation. So I think the appropriate way to use—

Mr. SHERMAN. You don't think Congress can keep its mouth shut and get classified briefings?

Mr. SCHWARCZ. No. I think that in almost every other arena, the way that international agreements work is you are authorized to enter into the agreement or to negotiate the agreement. You negotiate the agreement and then—

Mr. SHERMAN. But Mr.—Mr.—I know you are focused on insurance. We get briefed all the time about negotiations of every other international deal, whether it be trade deals. I had at least a dozen

White House briefings on the Iran deal as it was negotiated, so why would this be any different?

Mr. SCHWARCZ. Well, I know. I have no problem with briefings but my understanding is that this legislation would require waiting periods, would sort of essentially require the negotiating process to be—to be halted while you are briefed.

And that is not a good way to negotiate, to say, look, you can negotiate but you can only sort of negotiate this much. Then you have to go back and get approval.

Mr. SHERMAN. Right.

Mr. SCHWARCZ. And I think that undermines negotiation. So I think it would be perfectly reasonable to say we will give you the authority to negotiate a covered agreement, negotiate a covered agreement then come back and we will approve it.

Mr. SHERMAN. Well, I will ask Mr. Ehlert, is this going to prevent negotiation, that Congress gets briefed at various stages?

Mr. EHLERT. Not in my opinion at all.

Mr. SHERMAN. Thank you. I want to go on to the other issue. While we are here talking about whether FIO should have 5 employees or 10 employees there seems to be general agreement that what could undermine the insurance industry is credit default swaps and perhaps the security lending.

Ms. Wade, how hard is your organization pushing to make sure that the companies that don't even call themselves insurance companies that engage in credit default swaps become regulated insurance companies?

Ms. WADE. We as State regulators, through the holding company acts approve material transactions of insurance companies and their non-insurance—

Mr. SHERMAN. OK. But let us—

Ms. WADE —entities that may engage in—

Mr. SHERMAN. So you are a non-insurance company. As most of the—I mean, I realize the market is down to $10 trillion so maybe it is not as dangerous as it once was, but $10 trillion is real money.

Ms. WADE. Right. And we—

Mr. SHERMAN. And a lot of that is in companies that don't even report to you.

Ms. WADE. Correct, but we also require insurers to do more disclosure around their securities. We are also increasing—

Mr. SHERMAN. You are requiring this of insurers.

Ms. WADE. Yes.

Mr. SHERMAN. What about the trillions of dollars of companies who are issuing insurance and say they are not insurers because they say they are in the credit default swap business. I will give you an example.

If I have a deal where if my car is stolen, they write me a check, that is called automobile comprehensive insurance. If instead they say I can swap the pink slip of my too old, stolen, never-to-be-recovered car for a pink slip of a new car, you would still call that comprehensive auto insurance.

But if I do the same thing on a portfolio, then all of a sudden because I don't get cash, I get a portfolio of other securities, it is not called insurance. That would have brought AIG down. The professor says other things might have as well.

Professor, why can't we say credit default swap, which is insurance. It ensures that you do not have too great a decline in the value of your portfolio. Why can't we classify that as insurance?

Mr. SCHWARCZ. You could define it that way. It is not currently defined that way in Federal law. It is defined as a derivative because of, I believe, legislation that was passed about 17 years ago that I believe it was the Commodities Futures Modernization Act.

So I believe it was defined not to be insurance. And just the other point I will make is I think Commissioner Wade's point is illustrative of what I see as both the strengths and the weaknesses of the State-based system.

She says, well, we would look at it if there was a transaction between that company and the insurance company. That is because they are focused on insurance companies. But if you are regulating the—

Mr. SHERMAN. Well, the—

Mr. SCHWARCZ —industry as a whole—

Mr. SHERMAN. What we have is a definitional problem. Somebody figured out a way to ensure a portfolio in which if the insurance becomes activated, they don't write you a check. They give you another portfolio, and that rather stupid artifice has allowed them to escape insurance regulation.

And so I have got $10 trillion of insurance through credit default swaps that Ms. Wade doesn't even look at. I yield back.

Ms. WADE. Well, the SEC regulates credit default swaps and looking at the entire enterprise of an insurance company, holding company, is the way we look at the entire organization, the risk that they are taking on.

Mr. SHERMAN. Ms. Wade, you miss the point. A lot of this is done by companies that are not insurance holding companies. You don't even see them.

Ms. WADE. I understand, but the SEC regulates them.

Chairman DUFFY. The gentleman's time has expired.

Mr. SHERMAN. No, they don't.

Chairman DUFFY. The chair now recognizes the Chairman of the Subcommittee on Financial Institutions, the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. Means, as we were going through the covered agreement process with the previous FIO director, I know that those negotiations had a lot of impact and concern to you. And I know that now that you have a reinsurance business I understand in Europe? And can you tell me what the agreement, excuse me, the pros and cons of the agreement at this point? How it is affecting you or not affecting you?

Mr. MEANS. Sure. First of all, you know, our company does about $2 billion in total premium and our reinsurance company does about $120 million, so it is a small part of our business, but an important part of our business. And some of our reinsurance contracts are in Europe.

We, as you know, took a long time to do that negotiation to get that covered agreement to—agreed to. And in the end we did support it. So far it seems to be working OK, and we had some folks actually this week in Germany. And I think when I get back we will have a better feel for how it is working.

But as you know, before the covered agreement we were—in order for us to do business in the country of Germany—we were going to have to open up an office there, which, you know, just wasn't feasible for us. So we were relooking at probably seeing a reduction in our reinsurance operations of 20 percent to 25 percent that we have been able to overcome now because of that covered agreement.

Mr. LUETKEMEYER. I thank you for that and I know that during the discussion we had, some of the discussion points were made that if there was retribution there was some difficulties with our companies being able to do business over there that we could also put those constraints on companies when they come over here.

And it seemed again when we made that statement in committee and I had that pretty definitively mentioned, there was some concern. They were watching what we were doing, and I think the point was made that our insurance market is the biggest in the world. They are not.

They listened to us whether they want to acknowledge it or not. So, therefore, we need to be able to control our own markets and I think it is important that when we negotiate internationally that they understand that we are the big boys on the block.

We have the leverage and I understand our negotiators understand that they have the leverage. So I think it is important that we get those facts out there. Would you agree with that, Mr. Means?

Mr. MEANS. Absolutely. Matter of fact, I think at the end when it came down to getting the agreement I think that is exactly what happened is that they recognized that there could be, as you said retributions they were going to invoke those standards then we were going to look at possibly doing the same. And fortunately that got worked out. And—and we are glad that it happened.

Mr. LUETKEMEYER. In discussing one of the bills here deals with setting up the FIO Office as a part of the U.S. Trade International Affairs Office, which deals with trade.

And I think it may be a good spot for it from a standpoint that if you bring back to the table here their authority and ability to do things to just international agreements and where we have the ability as the bill indicates to provide a yes or no, a thumbs are up, a thumbs down on it, I think it gives a lot of leverage to that individual.

What do you think, Mr. Means?

Mr. MEANS. Well, I agree. I think there is a role for FIO in this process and that is to represent us internationally. I mean that is what the purpose was. But we need transparency, we need to make sure that they are listening to the NAIC, they are listening to State regulators and we are all on the same page.

They are not just out there on their own versus being a part of team USA. I think it is critical that they be a part of the team and they get input from the States and from NAIC and they listen to us. And I think maybe in the past, some of that didn't happen.

Mr. LUETKEMEYER. One of the concerns is that we are impacting our domestic companies, but we have a lot of companies that deal on an international basis as well. And so, always—is the discussion point as to how those companies deal with the new rules and regulations that are promulgated.

And I was curious where everybody—how much impact should those companies have on what we accept or don't accept here in this country? Because they are the big boys on the block so to speak. Yet, if they are willing to accept things that the rest is going to hurt the rest of industry, we've got to be very careful here. So I just want to answer the question here.

Mr. MEANS. I agree with you. I mean, I, you know, I would hate to see the, you know, some of the bigger insurers and reinsurers dictate to the rest of us what is gonna happen. You know, we deal with 20 States from a regulation standpoint and we think it works.

We also had the reinsurance companies, so we had to deal with some international regulation. We think that the way the State regulation is the way to go. And we think that with FIO representing us internationally, being our voice, but getting input from us and listening to us is the way to go. And we hope they listen to everybody, not just the big insurers.

Mr. LUETKEMEYER. I appreciate that. My time has expired.

Mr. Chairman, I yield back. Thank you.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the gentlelady from New York, Miss Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. My first question is for the entire panel. The FIO was created on the title five of Dodd-Frank to play an important role in monitoring and coordinating Federal and international efforts related to insurance.

In each of your opinions, how have these efforts changed under the Trump Administration from the Obama Administration? And I also would like to ask you to explain any changes you have observed in the management and operations of the FIO under the Trump Administration. Mr. Ehlert?

Mr. EHLERT. Thank you, Representative. I am sorry, I am not certain of the distinction between the changes in the FIO Office between the Obama Administration and the Trump Administration. So I probably cannot comment on your question.

Ms. VELAZQUEZ. OK.

Mr. SCHWARCZ. So just to comment. My impression is that FIO hasn't been issuing reports or having a voice really, that I am aware of, during the—now it has only been a short time, the Trump Administration.

But there was sort of active scrutiny, there were a lot of reports being issued in the Obama Administration under Director McCraith. And I think many of those reports were really quite strong.

And just to point out a few, there is a very strong report on the affordability issue, pointing out that there are issues that need to be addressed and saying that further research is required. And I am not sure that that is happening at FIO.

Similarly, there was a report on modernizing State insurance regulation that was issued under the Obama Administration. And I think that part of the problem is I believe we don't have a director right now at FIO, we just have an acting director.

So I think that that really ought to change. We should have some permanent, semi-permanent leadership so that the office can have some authority.

The other thing I would just point out is FIO's role was never intended just to be international. In fact its very first—under Dodd-Frank—its missions are laid out. Its very mission is to monitor the domestic industry and to look for gaps in insurance regulation that could cause systemic risks.

Its second is to monitor affordability. So international affairs is one component, but it is not the case that that was intended to be the sole component to FIO.

Ms. VELAZQUEZ. Thank you.

Mr. Means?

Mr. MEANS. Well, I think in my oral testimony I have commented on the fact that over the last few weeks, months, we have seen some improvement with the FIO office and we commend them for that. It seems to be better cooperation.

Ms. VELAZQUEZ. Ms. Wade?

Ms. WADE. Also, you know, in my remarks, we have seen improvement over the last several months in terms of the collaboration on international standard setting and more constructive dialog with team USA and a more coordinated effort to defend our system in the international arena.

Ms. VELAZQUEZ. OK. Thank you, Miss Wade. I would like for Mr. Schwarcz to comment on this, too. So some critics of the FIO would like to limit the FIO's role largely to international matters.

But isn't it important for the FIO to monitor and coordinate domestic insurance matters so that it might better represent the U.S. on the world stage? Miss Wade?

Ms. WADE. So the Federal Insurance Office is not a regulator. And we believe the appropriate role for it is in international affairs as a part of the Department of the Treasury.

We believe that that is a constructive role for them to coordinate across the Federal Government on international insurance issues.

Ms. VELAZQUEZ. Mr. Schwarcz?

Mr. SCHWARCZ. Again, you know, I obviously disagree. I mean it is not a regulator, that part I agree with. But that doesn't mean that it shouldn't have a role to play in monitoring and scrutinizing the system.

Earlier someone had suggested that it is not the case that a lot of State-based reforms were driven by Federal scrutiny. I would invite you to look at my testimony.

The accreditation standards, which is the bedrock of the State solvency system, is a direct response to Federal scrutiny. Risk based capital requirements were a direct response to Federal scrutiny.

The guarantee fund system were a direct response to Federal scrutiny. Rate regulation was a direct response to Federal scrutiny. The elimination of the ability of insurers to fixed rates was a direct response to Federal scrutiny.

So if you just look historically, it is factually accurate to say that the State-based system is a product of Federal monitoring and scrutiny.

Ms. VELAZQUEZ. Thank you. Mr. Chairman, I yield back.

Chairman DUFFY. The gentlelady yields back.

Now the chair now recognizes the gentleman from Illinois, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you, Chairman Duffy for holding this important hearing. Thank you all for being here.

The State-based system of regulating insurance in the United States has worked pretty well and I would say it is continuing to work and I especially see it working well in Illinois, my home State.

However, we should also not lose sight of the facts that our insurance markets extend beyond our home States and often times international markets play a role in determining what sort of products our constituents have access to and at what price.

This hearing, I believe is an important opportunity for the committee to revisit the new authorities that were provided to the Federal Government through to oversee the insurance industry as a result of the Dodd-Frank Act.

Mr. Ehlert, I wonder if I can address my first question to you. Federal Insurance Office Reform Act sponsored by Chairman Duffy and Mr. Heck require FIO to achieve a consensus with the States before advocating or agreeing to positions in international forums.

I wonder, do you believe that this consensus should be a simple majority, should it be unanimous, or something in between.

Mr. EHLERT. I think there has to be collaboration among the regulators, the NAIC and the Federal Insurance Office. Absent of sharing of ideas and opinions with regard to whether agreements internationally work.

The Federal Insurance Office is unable to actually have that expertise without the knowledge of the State-based insurance regulators who have been doing this for 150 years.

Professor Schwarcz indicated earlier, if we have all these changes that he says have been promoted by the Federal Government's scrutiny over the State insurance industry. Those changes were done without the requirement of having a Federal Insurance Office in place.

Mr. HULTGREN. Thanks.

Mr. EHLERT. To answer your question, sir—

Mr. HULTGREN. Yes, Mr. Means, do you have any thoughts on that?

Mr. MEANS. Well, I would agree totally. I think I disagree that every change that has happened in the insurance business is a result of some Federal idea somewhere.

I mean there has been a lot of changes in the insurance business that over my 40 years in the business that would have been not as a result of Federal involvement in any way.

And, you know, I will just say this, sometimes the Federal involvement can work really as a detriment, you know, we at Shelter—at Shelter Bank and we came under the—we were under the Office of Thrift Supervision and we came under the direction of the Federal Reserve as a result to Dodd-Frank and very successful bank.

A small bank, $120 million in assets, servicing small communities throughout our 20 States. And when the Federal Reserve came in and decided that they were going to take over, they basically said we are gonna—we are going to regulate, Mr. insurance company, through the bank. And we said no thank you.

So in a lot of these communities where large banks would pull out of, and there was no bank. We were there to be able to offer a service to our policy holders and our agents. In result to the Federal involvement, we couldn't do that. It just didn't make sense. Our expenses were gonna increase $1 million a year as a result of that.

Mr. HULTGREN. Miss Wade, how would you interpret the words consensus and how could FIO work with NAIC to help achieve this agreement?

Ms. WADE. Sure. So consensus and consultations doesn't mean we are gonna always agree. And we have a long tradition of collaborating across the 56 commissioners and a process for us to build a consensus position.

No one State can veto a position. We have to come together and come up with positions. So I believe consensus is working together. And that does not mean we will always agree.

Mr. HULTGREN. Yes. Following up, Miss Wade, I have heard a lot of frustration from the insurance industry. Especially smaller providers about duplicative data calls from FIO and the NAIC. Why do you think this is the case?

Dodd-Frank states that before collecting any data or information, FIO shall coordinate with each relevant Federal agency and State insurance regulator and any publicly available sources.

So wondering if you could talk about why you think there is this duplicative data calls? And then also, is NAIC committed to coordinating with FIO to avoid redundant or duplicative data requests?

Ms. WADE. The NAIC is working very closely with FIO on the TRIA data call to make sure that we are working together to avoid as much duplication as possible and be as coordinated in our data collection.

We are committed to working with our Federal partners in reducing the administrative burden on companies. But making sure that we get the information that we need in our role, in our different roles.

Mr. HULTGREN. And last, in my last few seconds here. Are there any instances under which it might make sense for FIO to lead these efforts. For example, the Terrorism Risk Insurance Program, TRIA, is administered by FIO.

So it would seem practical for them to use their expertise in this instance. Do you agree with that? Or are there other instances where you think FIO should take the lead?

Ms. WADE. I think we should be coordinated together to the extent possible.

Mr. HULTGREN. Great, thank you.

Thanks, chairman, I yield back.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the gentleman from California, Mr. Royce, for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. So at the outset I would really like to thank Professor Schwarcz here for setting the record straight on AIG.

From a regulatory standpoint, there were failures at both the State and the Federal level. And using capital from their insurance subsidiaries, they took from the subsidiaries with the approval.

With the approval of various State insurance regulators and the securities lending division in tandem with the financial products unit, thus put at risk the entire company. But it turns out it wasn't just the entire company put at risk.

It turns out it was the broader financial system as well, that was put at risk. So Mr. Chairman, without objection, I would like to submit for the record, an article penned by Hester Pierce, it was for the American Banker. It is entitled "AIG's Collapse, the Part Nobody Likes to Talk About."

And I think this hearing today proves that memory is very fleeting. Memory in terms of the failure at the Federal level and the failure at the State level with respect to regulation here.

Chairman DUFFY. Without objection.

Mr. ROYCE. Under the Constitution and the rulings of the Supreme Court, insurance is interstate commerce, and therefore subject to Federal regulation.

Only through an act of Congress have the States been able to maintain the power to regulate insurance. And the Federal Government has acted with the support of the Congress on many occasions.

When we had a flood insurance crisis, the Federal Government established the National Flood Insurance Program. When we had a terrorism risk insurance crisis, the Federal Government established Terrorism Risk Insurance Program. And we had a major financial crisis, the Federal Government established the Federal Insurance Office.

According to the work of the FIO annual report from last year, the failure in the long-term-care insurance market and the collapse of entreaty may be the next shoe to drop.

It is clear that the need for insurance expertise at the Federal level and a unified voice on international insurance matters is just as strong today as it was a decade ago.

The fact is, that States cannot uniformly act when there is a crisis, nor can they speak with one voice on behalf of other States or the Federal Government. That is just the practical reality here that we have experienced over and over again.

The NAIC has tried to fill this void, sometimes unconstitutionally tried to fill the void. The ORSA implementation that was lauded earlier was accomplished only through the use of incorporation by reference, a practice State legislators have severely criticized.

The NAIC State accreditation program requires its own handbooks, manuals and model legislation to be incorporated by reference into States' law. The NAIC handbooks and manuals are then amended frequently, frequently without approval by State representatives.

Maybe the question we should be asking today is how a private corporation—how could a private corporation have evolved into being able to effectively dictate nearly the entire insurance regulatory structure in the U.S.?

Hopefully, Mr. Chairman, we can have meetings on this in the future, have some hearings on this subject, I would hope.

And I will yield back the balance of my time, thank you.

Chairman DUFFY. The gentleman yields back.

And the chair now recognizes the gentleman from Washington, Mr. Heck, and a great co-sponsor of this package of bills, for 5 minutes.

Mr. HECK. Do you have to get unanimous consent so I can proceed (sic) so you don't interrupt me again, Mr. Chairman?

Chairman DUFFY. I will give you about 30 seconds here, then I will jump in on you.

Mr. HECK. Thank you, sir.

Chairman DUFFY. You are recognized.

Mr. HECK. I want to go back to something I mentioned in my opening statement about how to protect State-based regulation. I am recollecting that banks were chartered and supervised by States long before the first Federal bank regulators came along, I think in the 1860s. But, of course, today the dual banking system tilts more and more heavily toward Federal power.

Similarly, securities were first regulated under blue sky laws decades before the Securities Act of 1933. And, of course, today the SEC has preempted nearly all State securities regulation.

The Dodd-Frank Act rolled back a few preemptions of State mortgage regulations, but the general trend is a one-way ratchet toward more and more Federal imposition on State regulation.

For this committee, there is really only one area that has avoided the Federal power grab and that is, of course, insurance. But both before and after the crisis, the Treasury Department tried to create Federal regulation of insurance.

Now, I would argue actually in the instances that I had alluded too with increased Federal regulation that came about as a result of some wholesale collapse in the functioning of the market, such has not been the case in the area of insurance.

And I would like to ask each of you, starting on the end, your thoughts quickly, please, on how we can protect against this kind of inevitable tendency, this inevitable trend, for increasing Federal role where the problem statement isn't, frankly, very compelling?

Mr. EHLERT. I think these two bipartisan bills take a long step or a big step in protecting that from happening.

Mr. HECK. On behalf of Mr. Duffy and myself, I thank you.

Mr. EHLERT. Also Representative Heck, what we have to do is have advocation and promotion of our State-based and Federal regulatory systems of—which monitor insurance at an international level.

We cannot have conflicting laws at the Federal level that conflict with a proven functional State system regulatory body. So Congress needs to scrutinize what our Federal agencies are doing to make sure that we are not passing laws or rules or regulations that are in conflict with or duplicative of what our State insurance bodies, regulatory bodies, are already doing.

Mr. HECK. Thank you, sir.

Professor Schwarcz?

Mr. SCHWARCZ. I would say that it is not—look, if people were advocating getting rid of the State-based system, we could have that conversation. But to me the present dynamic we have is a healthy one and the Federal Government is playing some role in monitoring but not regulating and playing some role with respect to systemic risk.

But the appropriate level of regulation depends on the nature of the issue. If they are local issues, they should be regulated at the State level. But if we are dealing with the health of financial system, that needs to be regulated at the Federal level.

It doesn't make sense to have individual States protecting our broader financial system. And so I think that one needs to pay attention to the nature of the issue.

Mr. HECK. Thank you sir. I would be more receptive if I didn't think the system was working quite well to protect consumers in my State.

Mr. Means?

Mr. MEANS. Yes, and I think these two bills will go a long ways to doing what you suggested there and certainly appreciate your sponsorship. You know, you got 150 years of track record of it working and why lay another layer of bureaucracy? As I said in my oral statement, it is just not needed.

In my opinion, it is working at the State level. We deal with 20 different States and, you know, they are all different, but that is OK because they are close to the consumer and they know what is going on. And that is what makes it work, in my opinion.

Mr. HECK. If it ain't broke, don't fix it.

Mr. MEANS. There you go.

Mr. HECK. Ms. Wade?

Ms. WADE. We believe that these two pieces of legislation will help to bolster the State-based system that the Federal agency should be accountable just as State insurance commissioners are to their governors and legislatures.

That the Federal agencies are responsible to Congress and that, you know, when we advocate outside of the United States on international standards, this is recognition of how our U.S.-based system works.

Mr. HECK. Thank you.

I don't have a lot of time left, but I do want to observe with all due respect, Professor Schwarcz that if I were to restate your testimony as I understand it, it may sound a little bit, well, frankly, like parody, but I think you were literally saying that every good thing that has happened in State regulation of insurance has happened because of the Federal Government. Really?

Mr. SCHWARCZ. Well, if you actually read the testimony and look at every single example I give, I would challenge you to point out any single example I have that was not directly triggered by Federal scrutiny. So—

Mr. HECK. So—

Mr. SCHWARCZ —so you can characterize it, but if you actually want to look—

Mr. HECK —but you are making my point, sir, that if all the good things that have happened, which I strongly contest, have been a result of Federal pressure, why do we need an increased role in a specialized department?

And it is my time, sir, and it is up, and I yield back. Mr. Chairman, thank you.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman. Mr. Means, I wanted to thank you for calling attention in your testimony to the issues that are arising out of the Fed supervision in the insurance industry. This is an issue that I have been following very closely, and I am currently working on legislation to address it.

As you noted, Dodd-Frank gave the Fed new supervisory authority over certain insurers, including those that have depository institution affiliates. You testified that you closed your bank because it was not cost effective to deal with the Fed's examinations.

I know many other insurers have done that as well. In an era where banks are closing and consolidating and affordable financial services products are becoming less available for many Americans, and we are seeing no new banks being created, this dynamic is especially troubling.

You were discussing with Representative Hultgren in response to an inquiry about how your compliance costs affected your operations. And I am wondering if you might be able to elaborate on that a little bit? As you have made the decision to close your bank, was it just compliance costs? Was there other issues?

Mr. MEANS. No. It really was the fact that our costs were going to increase by about a million dollars a year where you are going to have to hire approximately four to five additional people at our bank. Approximately had 20 employees in it, so we are going to have to increase our staff by about 25 percent as a result to meet these compliance regulations.

It was a marginally—it was a successful bank, a small bank. But it was filling a void in communities where large banks had pulled out of and our agents had a relationship with customers where they could offer banking service.

And when the Federal regulators came in they just made it very clear to us that they were going to try to regulate the insurance company through the bank. And in my opinion that didn't make sense. You know, we deal with State regulators and we didn't need another layer of bureaucracy on top of that in having to deal with the Fed.

Mr. ROTHFUS. Do you believe that there are any consumer benefits to the Federal Reserve regulation of insurance holding companies?

Mr. MEANS. It was hard for me to see it. I do not believe there was. And I am not trying to criticize those employees that came. They were just there doing their job. But I saw no advantage, any help that it was going to give the consumers by doing what they were doing.

Mr. ROTHFUS. Commissioner Wade, as you know Dodd-Frank brought insurance companies that own thrifts under Fed supervision. As a result, the number of insurance companies that own thrifts has dropped dramatically from over 25 to about a dozen today.

Of those companies many of them has an insurance company as their top-tier holding company which is supervised by both the Federal Reserve and the State insurance department.

Under McCarran-Ferguson, the States are the primary supervisors of the business of insurance. While I understand that the Fed is working hard to fulfill its statutory mandate, I believe that the last few years have demonstrated that we can do much better in terms of regulatory efficiency and returning more authority back to the States.

Would you agree that we should work together to examine this regulatory system to create maximum regulatory efficiency?

Ms. WADE. Yes. We would agree to the extent that we can improve regulatory efficiency. Our job, first and foremost, is to protect the consumer and undue cost of regulation has an impact on consumers.

But we need to make sure that these companies are solvent and doing what they are supposed to be doing. And so the Federal Reserve has been coordinating with us as we develop our group capital standard and as they build their building block approach so that we can try to be as efficient as possible together and not duplicate data collection efforts as we do each of our roles in the regulatory space.

Mr. ROTHFUS. And thinking about answers to the issue, would you support a solution that allowed the Fed to have backstop regulatory authority of insurance savings and loan holding companies so that the agency could step in under certain circumstances but designate into States as the day-to-day supervisor of these insurance companies?

Ms. WADE. We support coordination between the agencies. We believe under the Holding Company Act we have very broad powers to regulate insurance holding companies.

Mr. ROTHFUS. Mr. Ehlert, as you know, we signed the USEU covered agreement on September 22. Like many members of this committee on both sides of the aisle, I had a number of concerns about not just the outcome but the process for negotiating and improving a covered agreement.

Looking back on the most recent covered agreement, what are your thoughts about how the process worked?

Mr. EHLERT. Well, I had general concerns about covered agreements under the current law and how they have the ability to preempt State law. Also, currently Congress does not have any disapproval process of those agreements.

The International Insurance Standards Act, bipartisan act proposed here today, would provide some disapproval process for Congress. That needs to be in place.

We don't want to be abdicating what our companies or the insurance companies here are going to be responsible to to the insurance regulators abroad. We want our State legislators in Congress to be making those laws that will govern us.

Mr. ROTHFUS. So in referencing the legislation we have under consideration, it is your opinion that the Duffy-Heck bill would address some of the problems that became apparent in the E.U.–U.S. agreement?

Mr. EHLERT. Definitely. Yes, sir.

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

Chairman DUFFY. The gentleman yields back.

Those are all of the members that we have to ask the panel questions. I want to thank you all for your testimony and your time and your statements that you have offered to our subcommittee and the wisdom that you provide.

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.

[Whereupon, at 11:48 a.m., the subcommittee was adjourned.]

A P P E N D I X

October 24, 2017

Statement

Of

Paul Ehlert

President of Germania Insurance

And

Chairman of the National Association of Mutual Insurance Companies

to the

United States

House of Representatives

Financial Services Subcommittee on Housing and Insurance

Hearing on

The Federal Government's Role in the Insurance Industry

October 24, 2017

Good Morning. My name is Paul Ehlert and I am President of Germania Insurance in Brenham, Texas. I also serve as the Chairman of the National Association of Mutual Insurance Companies. I am pleased to provide comments to the House Financial Services Subcommittee on Housing and Insurance on the proper role of the federal government in insurance regulation. We appreciate the subcommittee's focus, and Chairman Duffy's leadership, on ensuring the domestic U.S. property/casualty insurance industry remains vibrantly competitive for years to come.

Germania Farm Mutual Insurance Association began in 1896 with 31 farmers in rural Texas agreeing to insure each other and has grown to a group of companies writing $500 million in personal lines premium and insuring over 200,000 families across the state of Texas. Being a mutual insurance company, Germania exists solely for the benefit of our member policyholders. We remain true to our mission of providing fair and honest insurance protection to our members, and committed to maintaining our stability and financial strength to meet the needs of our policyholders when they need us most.

Germania strongly supports the state-based system of insurance regulation in the United States, and would be opposed to duplicative or increased federal involvement. Therefore, we would urge the Committee to swiftly consider and pass three pieces of legislation:

- Business of Insurance Regulatory Reform Act (H.R. 3746)
- International Insurance Standards Act (H.R. 3762)
- Federal Insurance Office Reform Act (H.R. 3861)

The State-Based System of Insurance Regulation

Congress enacted the McCarran-Ferguson Act (15 USC 1011, et seq.) in 1945 following the Supreme Court decision in United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944), that ruled that insurance was interstate commerce and subject to regulation by the federal government. The McCarran-Ferguson Act recognizes the local nature of insurance and provides for the continued regulation of insurance by the states.

The state-based regulatory system and the corresponding application of the McCarran-Ferguson Act's limited federal antitrust exemption have worked well to promote and maintain a healthy, vibrant, and competitive insurance marketplace for decades. There are nearly 7,800 insurers operating in the United States, the majority of which are relatively small. Virtually all studies done by academic and governmental entities have consistently concluded that the property/casualty insurance industry is very competitive under classic economic tests.

The national system of state regulation has, for more than a century, served consumer and insurer needs well. It has proven to be adaptable, accessible, and effective, with relatively few insolvencies and no taxpayer bailouts. Each state has adopted laws and regulations tailored to the unique needs of its consumers, yet all states also have a common financial solvency system through uniform accreditation requirements. State regulators and legislators consider and respond to marketplace concerns ranging from weather-related risks to specific economic conditions, medical costs, building codes, and consumer preferences. In addition, state regulators respond and adapt to inconsistencies created by various state contract, tort, and reparation laws.

Property/casualty insurance is inherently local, as opposed to national, in nature. State laws determine coverage and other policy terms. Local incidents of accident, weather, and theft impact pricing. Geographical and demographic differences among states also have a significant impact on property/casualty coverages. Weather conditions – hurricanes, wildfires, earthquakes, tornados, lightening, snow, ice, and hail, etc. – differ significantly from state to state.

The United States has 54 well-defined jurisdictions, each with its own set of laws and courts. The U.S. system of contract law is deeply developed and, with respect to insurance policies, is based on more than a century of policy interpretations by state courts. The tort system, which governs many types of contingencies at the heart of insurance claims, particularly those covered by liability insurance, is also well developed in state law.

With the ability to respond to unique local issues, the individual states serve as laboratories for experimentation and a launchpad for reform. State regulators develop expertise on issues particularly relevant to their state. Insurance consumers directly benefit from state regulators' familiarity with the unique circumstances of their state and the development of consumer assistance programs tailored to local needs and concerns. State regulators, whether directly elected or appointed by elected officials, have a strong incentive to ensure that insurers deal fairly and responsibly with consumers, and enforce a variety of consumer protection laws and regulations designed to ensure fairness and competitive equity.

State insurance regulators frequently interact directly with consumers. Nationwide, commissioners handle and respond to almost 1.8 million consumer inquiries and over 305,000 formal complaints in a single year. Inquiries range from general insurance information to content of policies to the treatment of consumers by insurance companies and agents. Most consumer inquiries and complaints are resolved successfully.

Public interest objectives are further achieved through review of policy terms and market conduct examinations to ensure effective and appropriate provision of insurance coverages. Regulators also monitor insurers, agents, and brokers to prevent activities prohibited by state unfair trade practices laws and take appropriate enforcement action.

The most important insurance consumer protection is ensuring the ability of the carrier to pay claims at a future date. Thus, ensuring the solvency and financial integrity of the insurer is a fundamental function of state insurance regulation.

State insurance regulators actively supervise all aspects of the business of insurance, including review and regulation of solvency and financial condition to guard against market failure and minimize company failure. The laws for financial condition and solvency are significantly similar from state to state as a result of financial accreditation standards set forth by the National Association of Insurance Commissioners.

A particularly effective feature of insurance regulation in the United States is the state guaranty fund system. Unlike banking and pension interests, insurance products carry no federal government guarantee, but are backed by other insurance companies through the guaranty fund system. This system is a model for anyone concerned about taxpayer bailouts of failing financial institutions.

State guaranty associations provide a mechanism for the prompt payment of covered claims of insolvent insurers. In the event of insurer insolvency, the guaranty associations assess other insurers to obtain funds necessary to pay the claims of the insolvent entity. Insurance companies writing property/casualty lines of business covered by a guaranty association are required to be a member of a guaranty association of a particular state as a condition of their authority to transact business in that state. Guaranty associations assess member insurers based upon their proportionate share of premiums written on covered lines of business in that state. Almost all states and territories have created post-assessment guaranty associations[1], and separate life and health insurance guaranty association systems also exist.

Each guaranty association has established detailed procedures for handling assets, filing claims, and making assessments. The guaranty association laws of most states and territories are based on the NAIC's model law. State legislators and regulators have crafted statutes and regulations regarding the creation and operation of the funds based on the needs of policyholders and in coordination with state laws. The funds operate to ensure payment of claims by other industry companies, rather than utilizing state or federal financial backstops. The insurance guaranty system and the state regulatory and oversight structure function well for insurers and consumers. The system avoids catastrophic financial loss to claimants and policyholders and maintains market stability, without governmental financial guarantees. As such, regulation and oversight of the guaranty fund system is appropriate at the state level and federal oversight is unnecessary in the context of the industry-funded, state-based system.

While the state insurance regulatory system functions very well in many respects, it is not without its shortcomings. State insurance regulation receives justified criticism for overregulation of price and forms, lack of uniformity, and protracted speed-to-market issues. Still, Germania believes that a reformed system of state-based insurance

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[1] With the exception of New York, the New York Security Fund and certain funds that cover only workers' compensation utilize a pre-assessment mechanism.

regulation is best suited for the U.S., and we continue to work with state legislators and regulators to modernize the system to meet the needs of a 21st century marketplace.

The Federal Role in Insurance Regulation

Germania has significant concerns with the expansion of the federal role in insurance regulation. New federal regulatory activities or authority, whether designed to replace or duplicate the state system, would likely disrupt well-functioning markets, introduce competitive inequities, and generate confusion among consumers. Unfortunately, since the passage of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), we have seen a growing level of costly, duplicative, and often unnecessary activity in Washington and would strongly urge Congress to consider ways to reverse this trend.

To that end, Germania urges the House Financial Services Committee to take up and pass three bipartisan pieces of legislation introduced recently by Chairman Duffy and some of his Democrat colleagues.

<u>Federal Insurance Office Reform Act – H.R. 3861</u>

Dodd-Frank established the Federal Insurance Office (FIO) to provide expertise and information on the insurance industry to policymakers in Washington, D.C. It was not given regulatory or oversight powers, but was provided some authorities that have created unnecessary duplication.

While not speaking for anyone else today, I believe the vast majority of U.S. domiciled property/casualty insurance companies would be in favor of eliminating the FIO entirely. The National Association of Mutual Insurance Companies, the Independent Insurance Agents and Brokers of America, the Professional Insurance Agents, and the National Association of Insurance Commissioners have all called for the outright elimination of the office. Germania would also strongly support this – the FIO is unnecessary, performs many redundant functions better left to the states, needlessly utilizes administrative capabilities, and does not provide public benefits to justify its cost. In addition to being unnecessary, in many cases the office is actually creating duplicative burdens and negatively impacting the insurance industry.

In the legislative process that produced the Dodd-Frank Act, the FIO was given a dubious statutory mandate to study the affordability and availability of certain insurance lines in traditionally underserved communities. The office has interpreted this mandate to mean it must attempt to objectively define a subjective concept, a project which will inevitably lead to erroneous conclusions about the state of insurance markets without consideration of the actual costs of providing insurance products. State insurance commissioners across the country are committed to ensuring consumers in their state are protected. That is the role of state regulators, not the FIO. Erroneous conclusions aside, the mere act of even conducting these studies has the negative effect of forcing costs on insurers who must comply with annual data calls to produce them.

The FIO further encroached on the state regulators' consumer protection function when it issued its November 2016 report on consumer protections. This report – which has a tenuous (at best) relationship with its statutory mandates and was not requested by Congress – lacked substance, and was thoroughly and simply political, throwing out alarmist conclusions and dubious proposals.

Even in its chief role as an insurance information resource the FIO has added only cost and duplication. The Terrorism Risk Insurance Act reauthorization bill passed in 2015 mandated that the FIO study the terrorism insurance marketplace and identify data to be collected to do so. Under the law, the FIO is required to work to obtain this information from relevant state, federal, or other public sources (31 U.S. Code § 313) before engaging in any mandatory data calls. The National Association of Insurance Commissioners has since launched its own TRIA data collection process and the FIO did not work with the NAIC on a common template that would allow for one data call. Companies writing TRIA-covered lines are currently subject to duplicative data collection/reporting requirements to achieve very similar goals. Germania has been pleased to hear that evidently, there is a process underway to rectify this going forward so companies are not subject to two data calls.

Ultimately, while we would support a full repeal of the statutory language establishing FIO, legislation designed to reform and refocus the office such as H.R. 3861, the Federal Insurance Office Reform Act, recently introduced by Representatives Sean Duffy and Denny Heck, would be a major step in the right direction. As a strong supporter of the state-based system of insurance regulation, Germania believes that it is essential that any federal office dealing with the property/casualty insurance industry be very carefully crafted, its purpose made clear, and its authority strictly limited to that purpose. H.R. 3861 would help to do exactly that.

As a part of the effort to refocus and right-size the FIO, the legislation moves the office under the Treasury Department's Office of International Affairs. This will help keep the mission focused on coordinating federal efforts and representing the U.S. market, insurers, and policyholders abroad rather than attempting to regulate the insurance industry here at home. In an effort to keep the office from getting out of its lane, the bill would also cap the number of employees at five; strictly limit the office's subpoena authority; explicitly prohibit the FIO from participating in regulators' supervisory activities; and require more consultation between the FIO and the functional state regulators. We believe all of these changes would be valuable.

<u>International Insurance Standards Act – H.R. 3762</u>

Over the last several years, the Financial Stability Board (FSB) has become an increasingly important and influential regulatory organization for the global financial services sector. Re-established in 2009 in the wake of the financial crisis, the FSB's core mission is to promote regulatory standards that ensure the stability and soundness of the world's financial system. Pre-crisis, a precursor organization, the Financial Stability Forum, had a role of monitoring, coordinating, and communicating among regulatory jurisdictions. However, the mandates provided in the FSB's charter go well beyond generally-expressed objectives, and require that the FSB assume a direct role in monitoring how various countries implement global rules at home.

The overreach of a group of mostly foreign policymakers exerting their vision of regulation on our banking system is particularly troubling for the U.S. property/casualty insurance industry. During a Senate Banking Committee hearing in July of 2015, Dr. Adam Posen – testifying in support of many of the FSB's activities and decisions – said, "Where the FSB at present is getting things wrong, in my opinion, largely has to do with its approaches to coordinating regulation of the non-bank parts of the financial system." Germania wholeheartedly agrees.

Multilateral organizations like the FSB have always been intended to promote and foster economic growth while maintaining financial stability, not to regulate financial services markets everywhere in the world. Over the last decade, the movement toward more formulaic, prescriptive, and intrusive standard development has accelerated at an alarming rate. FSB decisions are especially impaired in the insurance arena as its membership does not include U.S. representatives with insurance expertise, and it is not transparent in its deliberations. If U.S. property/casualty insurers are not represented or allowed to speak on their own behalf the FSB is bound to adopt ill-informed concepts and push global standards that do not recognize the differences in our business model. One-size-fits all regulation does not work within the insurance industry, and certainly creates challenges when it is applied to all financial institutions.

There are also significant concerns with the FSB's review and guidance of the policy development work of the International Association of Insurance Supervisors (IAIS). Following the financial crisis, the IAIS was directed to begin work on a Common Framework for the Supervision of Internationally Active Insurance Groups (IAIGs), also known as ComFrame. The IAIGs are defined only in ComFrame; this category of company was never contemplated nor defined in the Dodd-Frank Act, nor any U.S. government regulatory regime. This new framework, which started as new standards designed to promote cooperation and coordination among insurance supervisors, quickly became a series of new requirements for a segment of insurers.

As an example, in 2013 – without warning or clear reasons – the FSB met with IAIS leadership and informed them that IAIGs should adhere to a global consolidated capital requirement similar to the Basel II and III requirements for banks. The IAIS was ordered to design, field test, and adopt such global capital requirements for the IAIGs by 2016. The pace of this edict was unreasonable and unworkable, but IAIS leaders indicated they had no choice but to comply.

Since the FSB's mandate, the IAIS Executive Committee has made numerous decisions regarding the structure and design of the International Capital Standard (ICS) for the IAIGs without actually stating the problem the FSB was trying to solve, and without explaining why the decisions were made. The most troublesome of these decisions include:

- the insistence on a highly detailed, prescriptive formula for the ICS that would be applied to all countries;
- the requirement that all countries use the same valuation/balance sheet without regard to the costs and implications; and
- the insistence that the capital resources that companies use to meet the obligation be identical even when the capital instruments available to companies vary across countries.

Despite the goal of the IAIS to achieve a comparable ICS for all IAIGs around the globe, the application of the same capital standard to unique companies that come 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 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 by a single, one-size-fits-all formula. In their zeal to achieve comparability, the FSB – through the IAIS – will succeed only in generating unnecessary costs to governments and insurers.

Germania believes that a successful global effort should not create unnecessary competitive asymmetries among companies domiciled in different, but equally well-supervised, jurisdictions. Instead, what is needed is a flexible and dynamic capital assessment that would recognize and improve understanding of diverse, successful approaches to solvency regulation. Such an approach would be principle-based and outcomes-focused. Under this approach, supervisors could achieve the desired goals of policyholder protection and insurer solvency without the costs of implementing new global systems in nearly every country in the world.

To be clear, we believe that American insurers should be positioned to compete in the international insurance market if they so choose. That means participating in international discussions on insurance and insurance regulation, and where appropriate, communication and coordination between international regulatory authorities. Working together will improve understanding of differing regulatory systems and may well result in shared best practices. However, while cooperation and coordination on the regulatory front is a positive thing, it should not result in abdication of regulatory authority to foreign jurisdictions or quasi-governmental bodies. Ultimately, U.S. representatives at international fora should advance policy positions that represent the best interests of U.S. insurance consumers, the insurance markets, the insurance regulators, and the U.S. economy in general.

Congress should support this position by passing H.R. 3762, the International Insurance Standards Act, also recently introduced by Reps. Duffy and Heck. In addition to increasing the transparency of the process when federal officials are participating at international insurance standard-setting bodies, the bill would prohibit those officials from agreeing to new international standards which do not comport with existing U.S. state and federal law. The legislation would also provide a process by which Congress could vote on a resolution of disapproval for any standard or covered agreement that federal officials negotiate. Germania believes that these steps would help to ensure that foreign regulatory standards, inappropriate for our system and markets, would not be unilaterally imported to the U.S.

Business of Insurance Regulatory Reform Act – H.R. 3746

The Dodd-Frank Act also created the Consumer Financial Protection Bureau. Title X of the law explicitly exempted the business of insurance from the purview of the Bureau except to the extent the "enumerated consumer laws" (e.g., Fair Credit Reporting Act) already addresses a specific insurance issue. Essentially, Dodd-Frank reaffirmed the status quo and reiterated that the regulation of insurance had been delegated to the states under the McCarran-Ferguson Act.

Unfortunately, the Bureau has demonstrated its willingness to "tip toe" into insurance regulation and explore the extent of its powers in an open-ended and sometimes confusing manner. For example, the Bureau is willing to keep the door open to regulate a loan to an insurance policyholder arising out of a policyholder's own life insurance policy even though state insurance regulators aggressively occupy the field and consider this the business of insurance. While the probability of such action by the Bureau is likely low, it illustrates that the Bureau reserves the ability to revisit the issue at its convenience.

State insurance commissioners have a strong focus on consumer protection, but they must also balance insurers' solvency needs. Allowing the Bureau to attempt to expand the federal government's role in regulating insurance products would be counter-productive and ultimately could result in the bureau's regulations conflicting with the directives of the functional state regulators. Rather than allow this issue to build and create unintended consequences, we believe it is better to clarify the issue upfront.

To prevent such an eventuality, Germania strongly supports H.R. 3746, the Business of Insurance Regulatory Reform Act. This bipartisan legislation – introduced by Reps. Sean Duffy and Gwen Moore – would simply clarify and reinforce the original intention of the Dodd-Frank and McCarran-Ferguson Acts; namely, that the Bureau should only exercise regulatory jurisdiction over the business of insurance where it has clear authority from Congress and that deference should be given to state insurance regulators when it comes to the business of insurance. In any effort to right-size the federal role in insurance regulation, avoiding the kind of duplication which would be created with the Bureau involved in regulating insurance must be at the top of the priority list.

Conclusion

Germania strongly supports the state-based system of insurance regulation in the United States. Federal and international encroachment into insurance regulation almost always leads to costly and duplicative oversight with no subsequent benefit for consumers. Rather, it typically results in higher costs and fewer choices for policyholders. I would urge the committee to always identify and keep in mind the problems you are trying to solve before supporting any new regulatory regimes or activity as there are inevitably unintended consequences for consumers and markets. For example, the creation of the Federal Insurance Office may have seemed like a good idea at the time, but the experiment has yielded clear evidence that the mission and scope of the office require greater focus and further refinement.

We would urge the Committee to swiftly consider and pass the Federal Insurance Office Reform Act (H.R. 3861), the International Insurance Standards Act (H.R. 3762), and the Business of Insurance Regulatory Reform Act (H.R. 3746). I appreciate the opportunity to testify and look forward to working with the committee going forward.

Testimony
Rick Means
President and Chief Executive Officer
Shelter Insurance Company

The Federal Government's Role in the Insurance Industry

Subcommittee on Housing and Insurance
Committee on Financial Services
United States House of Representatives
October 24, 2017

Thank you, Chairman Duffy, Ranking Member Cleaver and members of the Subcommittee for holding this important hearing on the Federal government's role in the insurance industry and for inviting me to testify today.

My name is Rick Means and I am the President and Chief Executive Officer of Shelter Insurance Company. Shelter is a mutual company headquartered in Columbia, Missouri. We provide auto, property, business and life insurance in twenty states and conduct business internationally. I am also a member of the Board of Governors of the Property Casualty Insurers Association of America (PCI), which is composed of nearly 1,000 members and represents a broad cross-section of insurers.

I am pleased to testify in strong support of bills that are the subject of this hearing: (1) H.R. 3861, the Federal Insurance Office Reform Act of 2017; and (2) H.R. 3762, the International Insurance Standards Act of 2017. These important bills recognize that our state-based system for insurance regulation has protected consumers and fostered competitive insurance markets for over 150 years. I am also pleased to offer some perspective on the need for Congress to ensure that both the Federal Reserve Board and the Consumer Financial Protection Bureau (CFPB) do not disrupt, duplicate, or displace state supervision of insurance.

Federal Insurance Reform Act of 2017 (H.R. 3861). The Dodd-Frank Act reaffirmed the primacy of state regulation. It also created the Federal Insurance Office (FIO), the primary value of which was to assist in the coordination of federal insurance policy and to represent the federal government in international regulatory discussions. Dodd-Frank expressly states that Treasury does not have general supervisory authority over the business of insurance – a clear signal that Congress did not intend for FIO to usurp state regulatory authority. However, some additional provisions pertaining to domestic regulatory matters were added to Dodd-Frank late in the legislative process without serious consideration of their negative impact on state regulation and state regulated markets. H.R. 3861 addresses these problems by re-focusing FIO's activity on international regulatory discussions in consultation with the states and by reducing its domestic activities that are duplicative of state regulation.

FIO's primary purpose was to provide a unified voice for the U.S. insurance market and regulatory community in international discussions. But FIO has used its other powers to impose burdensome data calls on auto insurers in an effort to influence rate setting – a function that properly belongs only with state regulators. FIO has also issued reports opining on a number of matters that state regulators handle exclusively, including underwriting standards.

Dodd-Frank also granted FIO exceedingly and unusually broad subpoena powers far beyond the power granted to most other Treasury agencies, especially in view of the fact that FIO was never intended to be a regulatory agency. Treasury's current subpoena powers generally fall into three categories: (1) formal administrative proceedings; (2) criminal or civil investigations and enforcement of laws/regulations; and (3) Inspector General investigative powers. FIO's subpoena power does not fit into any of the above categories and is not constrained in any way other than that the FIO must believe that the information it wants is relevant to its mission. No suspicion of criminal or civil violations of a law or regulation is required and no formal administrative proceeding must be initiated (indeed, as a non-regulator, FIO lacks the authority to initiative administrative proceedings). More importantly, the FIO does not need subpoena power, which duplicates the powers that state insurance regulators already possess to obtain information and data from insurers, either by subpoena or otherwise. States have the ability to take disciplinary action, including license revocation and civil and criminal penalties, against any insurer that fails to provide its regulator with required information. In recognition of this, H.R. 3861 would repeal FIO's subpoena power and its ability to conduct data calls directly on insurers, thus requiring FIO to work closely with state insurance regulators when it needs information.

To ensure that FIO is primarily focused on international matters and does not inappropriately intrude on state regulatory authority, H.R. 3861 would move FIO to the Office of International Affairs within the Treasury Department and focus its role on international matters. FIO would be empowered to speak for Treasury in international discussions on insurance matters. It would also limit FIO's staffing resources to ensure it does not engage in mission creep and inappropriately intrude into areas that are more properly within the authority of state insurance regulators.

The state insurance regulatory system has a 150 year track record of comprehensive consumer protection for insurance policyholders. The insurance sector has been stable throughout the last several financial crises, and despite a confluence in the last decade of record storms, market contractions, and regulatory changes, there have been no major recent insolvencies, the industry has achieved record levels of capitalization, and our residual markets for consumers and businesses are at or near historic lows. This suggests that overall private sector insurance availability is better than ever for consumers. H.R. 3861 would ensure that the state system will continue to extend this excellent track record unimpeded by Federal meddling. Instead, it would focus FIO on the important international functions to which it is most suited. Shelter urges the Committee and the Congress to pass this bill.

International insurance Standards Act of 2017 (H.R. 3762). International insurance regulatory discussions and standard setting has greatly increased since the financial crisis and is often conducted behind closed doors, unaccountable to the public and to Congress. The Treasury and Federal Reserve Board and the NAIC are responsible for representing the interests of the U.S. But instead of strengthening the U.S. voice as Congress intended in Dodd-Frank, the federal agencies have often disagreed with state regulators, thereby actually weakening the U.S. voice. Unfortunately, FIO has too often taken positions in international forums that are at odds with those of the state insurance regulators. For example, the International Association of Insurance Supervisors (IAIS) decided to hold closed meetings despite the strong objections of state insurance regulators, who believe that the IAIS should conduct its business transparently. State insurance regulators reported that FIO not only failed to represent that position at the IAIS, but the FIO director took the opposite position and supported closing the IAIS meetings, thus excluding consumer groups as well as market participants and U.S. insurance regulators from policy discussions.

The Federal government is the functional regulator of many depository institutions, and so can speak for the U.S. banking regulatory community in international discussions. However, it is not the functional regulator of the insurance industry, and thus can only speak for the insurance regulatory community if it first consults with state regulators and then advocates their views in international discussions.

The IAIS is not a regulatory body and in its standard-setting activities generally does not discuss confidential or company-specific information. Rather, it deliberates on best practices and potential global insurance standards in a forum where all stakeholders should be able to have a voice – similar to the process for domestic insurance standard discussions at the National Association of Insurance Commissioners (NAIC). I have attached to my testimony a chart showing a myriad of workstreams at the

IAIS that could have a significant impact on U.S. insurers and insurance regulators, including the development of various international prudential standards. While such international standards are not legally binding on U.S. regulators, they will inevitably exert a strong influence on U.S. insurance regulation over time. Many non-U.S. participants in these discussions are far more steeped in banking regulation than insurance regulation, posing a grave danger that standards that are inappropriate for insurers generally and for the U.S. market in particular could begin to take hold here. U.S. regulators and market participants must have a say in the development of those international standards. But the IAIS operates in a non-transparent manner and excludes all U.S. stakeholders other than the Federal government from participating in most meetings.

H.R. 3762 would correct this problem and assure that the U.S. can speak strongly and with one unified voice in international discussions. It includes a congressional finding that the state regulatory system has worked well, that protection of solvency is the paramount regulatory objective, and that Dodd-Frank reaffirmed the State-based regulatory system. It would also require federal agencies to consult closely with states (as well as the International Trade Advisory Committee on Services and Finance Industries) and prohibit federal agencies from agreeing to an international standard unless it is consistent with state and federal law and recognizes U.S. law as complying. The bill would also require federal agencies to closely consult with state regulators to determine if an international standard would require changes to federal or state laws.

H.R. 3762 would provide some much-needed direction and guardrails for U.S. negotiators in international discussions on insurance matters and will also provide for appropriate Congressional oversight of any international insurance agreements. At the same time, it would help assure strong representation of U.S. interest in international insurance regulatory discussions. For these reasons, Shelter urges the Committee and the Congress to pass H.R. 3762.

Consumer Financial Protection Bureau (CFPB) Insurance Exemption. Although not the primary subject of this hearing, we do also note that the Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB), but expressly provided that the CFPB would have no authority to regulate the "business of insurance." The term "business of insurance" is defined broadly in the statute to include "all acts necessary to the writing or reinsuring" of risks. . ." Despite this statutory exemption, the CFPB has taken actions that involve insurance activities and products that fall within the authority of state insurance regulators, creating duplicative and potentially conflicting oversight.

We know that Chairman Duffy and Representative Moore have introduced legislation (H.R. 3746) to clarify the existing exemption to ensure that all entities will be subject to state regulation with respect to any activities that constitute the "business of insurance," which is consistent with the intent of Congress when it passed the Dodd-Frank Act in 2010. This technical clarification will ensure that there will not be duplicative or conflicting regulations in the future and will provide certainty for insurance companies and consumers. We look forward to working with the bill's sponsors and the Committee on this important legislation.

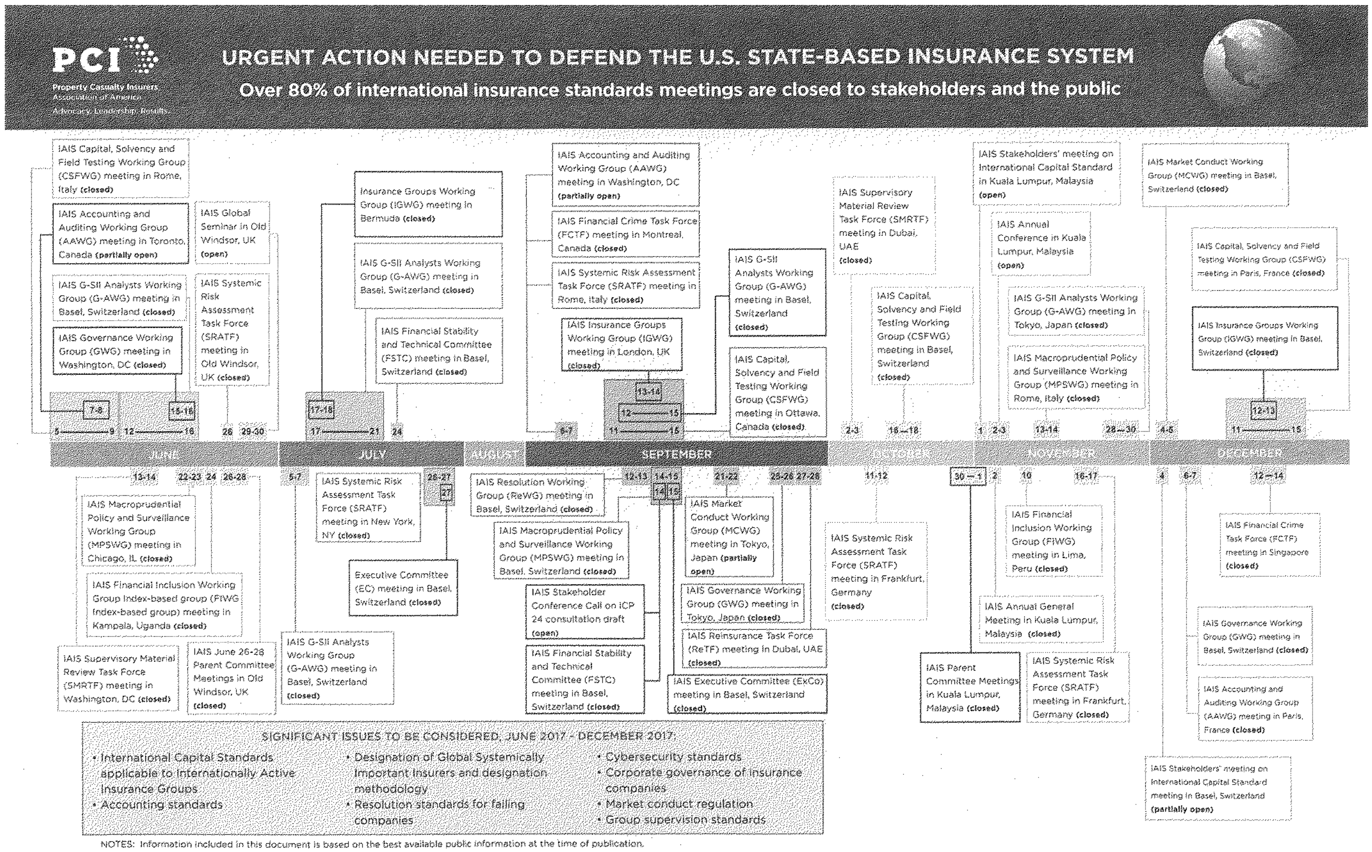
Federal Reserve Board Supervision of Insurance. We also want to call the Subcommittee's attention to the need to examine the Federal Reserve Board's regulatory authority over insurers. The Dodd-Frank Act brought two categories of insurance companies under the Board's supervisory authority (1) insurance companies designated as systemically important by the Financial Stability Oversight Council (FSOC); and (2) insurance holding companies that are affiliated with depository institutions. Consistent with the McCarran-Ferguson Act, Congress did not intend for Federal supervision to disrupt or displace state supervision of insurance.

Unfortunately, the Dodd-Frank Act resulted in the Federal Reserve Board conducting exhaustive examinations of small financial institutions owned by nonbank financial institutions. One of those was our own, the Shelter Financial Bank. We opened that institution 17 years ago to serve as a community bank, primarily for our agents and policyholders. It was profitable and very stable, but the new Federal Reserve supervisory requirements added more than $1 million to our annual expenses. For this reason, we reluctantly decided in 2013 to close it. This expensive new federal supervision did nothing to protect consumers and instead worked to reduce competition and deprive consumers of banking options. We do not believe this is what Congress had in mind when it enacted Dodd-Frank.

In addition to the bills being discussed today, we also urge Congress to enact legation that appropriately adjusts federal regulation of insurance to address these issues. Such legislation should limit the Federal Reserve's day-to-day supervision of depository institution subsidiaries that meet federal capital requirements.

Conclusion

Thank you again for your efforts to recognize and support the success of state-based insurance regulation. We strongly support the passage of H.R. 3861, and H.R. 3762, and we look forward to working with the Committee and serving as a resource as this legislation progresses.


PCI
Property Casualty Insurers Association of America
Advocacy. Leadership. Results.
URGENT ACTION NEEDED TO DEFEND THE U.S. STATE-BASED INSURANCE SYSTEM
Over 80% of international insurance standards meetings are closed to stakeholders and the public
JUNE
JULY
AUGUST
SEPTEMBER
OCTOBER
NOVEMBER
DECEMBER
IAIS Capital, Solvency and Field Testing Working Group (CSFWG) meeting in Rome, Italy (closed)
IAIS Accounting and Auditing Working Group (AAWG) meeting in Toronto, Canada (partially open)
IAIS Global Seminar in Old Windsor, UK (open)
IAIS G-SII Analysts Working Group (G-AWG) meeting in Basel, Switzerland (closed)
IAIS Systemic Risk Assessment Task Force (SRATF) meeting in Old Windsor, UK (closed)
IAIS Governance Working Group (GWG) meeting in Washington, DC (closed)
IAIS Macroprudential Policy and Surveillance Working Group (MPSWG) meeting in Chicago, IL (closed)
IAIS Financial Inclusion Working Group Index-based group (FIWG Index-based group) meeting in Kampala, Uganda (closed)
IAIS Supervisory Material Review Task Force (SMRTF) meeting in Washington, DC (closed)
IAIS June 26-28 Parent Committee Meetings in Old Windsor, UK (closed)
Insurance Groups Working Group (IGWG) meeting in Bermuda (closed)
IAIS G-SII Analysts Working Group (G-AWG) meeting in Basel, Switzerland (closed)
IAIS Financial Stability and Technical Committee (FSTC) meeting in Basel, Switzerland (closed)
IAIS Systemic Risk Assessment Task Force (SRATF) meeting in New York, NY (closed)
Executive Committee (EC) meeting in Basel, Switzerland (closed)
IAIS G-SII Analysts Working Group (G-AWG) meeting in Basel, Switzerland (closed)
IAIS Accounting and Auditing Working Group (AAWG) meeting in Washington, DC (partially open)
IAIS Financial Crime Task Force (FCTF) meeting in Montreal, Canada (closed)
IAIS Systemic Risk Assessment Task Force (SRATF) meeting in Rome, Italy (closed)
IAIS Insurance Groups Working Group (IGWG) meeting in London, UK (closed)
IAIS G-SII Analysts Working Group (G-AWG) meeting in Basel, Switzerland (closed)
IAIS Capital, Solvency and Field Testing Working Group (CSFWG) meeting in Ottawa, Canada (closed)
IAIS Resolution Working Group (ReWG) meeting in Basel, Switzerland (closed)
IAIS Macroprudential Policy and Surveillance Working Group (MPSWG) meeting in Basel, Switzerland (closed)
IAIS Stakeholder Conference Call on ICP 24 consultation draft (open)
IAIS Financial Stability and Technical Committee (FSTC) meeting in Basel, Switzerland (closed)
IAIS Market Conduct Working Group (MCWG) meeting in Tokyo, Japan (partially open)
IAIS Governance Working Group (GWG) meeting in Tokyo, Japan (closed)
IAIS Reinsurance Task Force (ReTF) meeting in Dubai, UAE (closed)
IAIS Executive Committee (ExCo) meeting in Basel, Switzerland (closed)
IAIS Supervisory Material Review Task Force (SMRTF) meeting in Dubai, UAE (closed)
IAIS Capital, Solvency and Field Testing Working Group (CSFWG) meeting in Basel, Switzerland (closed)
IAIS Systemic Risk Assessment Task Force (SRATF) meeting in Frankfurt, Germany (closed)
IAIS Stakeholders' meeting on International Capital Standard in Kuala Lumpur, Malaysia (open)
IAIS Annual Conference in Kuala Lumpur, Malaysia (open)
IAIS G-SII Analysts Working Group (G-AWG) meeting in Tokyo, Japan (closed)
IAIS Macroprudential Policy and Surveillance Working Group (MPSWG) meeting in Rome, Italy (closed)
IAIS Financial Inclusion Working Group (FIWG) meeting in Lima, Peru (closed)
IAIS Annual General Meeting in Kuala Lumpur, Malaysia (closed)
IAIS Parent Committee Meetings in Kuala Lumpur, Malaysia (closed)
IAIS Systemic Risk Assessment Task Force (SRATF) meeting in Frankfurt, Germany (closed)
IAIS Market Conduct Working Group (MCWG) meeting in Basel, Switzerland (closed)
IAIS Capital, Solvency and Field Testing Working Group (CSFWG) meeting in Paris, France (closed)
IAIS Insurance Groups Working Group (IGWG) meeting in Basel, Switzerland (closed)
IAIS Financial Crime Task Force (FCTF) meeting in Singapore (closed)
IAIS Governance Working Group (GWG) meeting in Basel, Switzerland (closed)
IAIS Accounting and Auditing Working Group (AAWG) meeting in Paris, France (closed)
IAIS Stakeholders' meeting on International Capital Standard meeting in Basel, Switzerland (partially open)
SIGNIFICANT ISSUES TO BE CONSIDERED, JUNE 2017 - DECEMBER 2017:
• International Capital Standards applicable to Internationally Active Insurance Groups
• Accounting standards
• Designation of Global Systemically Important Insurers and designation methodology
• Resolution standards for failing companies
• Cybersecurity standards
• Corporate governance of insurance companies
• Market conduct regulation
• Group supervision standards
NOTES: Information included in this document is based on the best available public information at the time of publication.

TESTIMONY OF DANIEL SCHWARCZ

Professor of Law, University of Minnesota Law School

before the

United States House of Representatives

Committee on Financial Services

Subcommittee on Housing and Insurance

regarding "The Federal Government's Role in the Insurance Industry"

October 24, 2017

Chairman Duffy, Ranking Member Cleaver, and members of the Subcommittee, thank you very much for this opportunity to discuss the federal government's role in the insurance industry. In my testimony today, I will first argue that it is essential that the federal government maintain a consistent and robust role in monitoring domestic insurance markets and their regulation by the states. Although state insurance regulation enjoys broad support in today's political climate, this regulatory system was forged largely by states' responses to intense federal scrutiny. Indeed, it would hardly be an over-statement to say that almost every major advance in state insurance regulation over the last half-century can be directly linked to federal criticism, often paired with the real threat of federal preemption.

Until 2010, such federal scrutiny of state insurance regulation was triggered either by high-profile scandals or concerted industry lobbying. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") helped to systematize and enhance federal monitoring of insurance regulation with the creation of the Federal Insurance Office (FIO). FIO's insurance expertise and consistent assessment of gaps, deficiencies, and inefficiencies in state insurance regulation has helped prompt improvements in state insurance regulation before the underlying problems can trigger front-page news stories or concerted lobbying efforts by aggrieved and coordinated interests. For these reasons, proposals to deprive FIO of the authority, resources, and independence to monitor state insurance regulation and domestic insurance markets are, in my view, deeply misguided.

Second, my testimony will emphasize that the federal government has a special responsibility to monitor, and where necessary supplement, state insurance regulation with respect to the regulation of systemic risk. A core lesson of the 2008 financial crisis is that insurers can create important systemic risks to the larger financial system.[1] Yet as the catastrophic implosion of AIG in 2008 vividly demonstrated, individual states face important structural, legal, and political limitations in their capacity to anticipate and prevent systemic risk. It is for precisely these reasons that Dodd-Frank not only directed FIO to identify "issues or gaps in the regulation of insurers that could contribute to a systemic crisis," but also tasked the Financial Stability Oversight Council ("FSOC") with responsibility for identifying nonbank financial firms whose "material financial distress . . . could pose a threat to the financial stability of the United States." Firms that are designated as systemically risky through this process are subject to supervision by the Board of Governors of the Federal Reserve System (the Fed) as well as enhanced prudential standards.

It is imperative that Congress and the Trump Administration maintain the integrity and objectivity of this FSOC designation scheme, notwithstanding its admitted imperfections and limitations. Contrary to the assumptions of many of its critics, the

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[1] See Daniel Schwarcz & Steven Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. Chi. L. Rev. 1569 (2014).

FSOC designation scheme was not designed to consistently adjudicate between safe and risky firms as a court might, or to create a mathematical formula that firms can apply to their balance sheets to see if they are systemically risky. Such precision is impossible given the constantly evolving nature of systemic risk. Instead, FSOC designation was established to deter nonbank financial firms from taking on systemically significant risks, and encourage those that come too close to this line to de-risk. Judged from this vantage point, the FSOC designation scheme has largely achieved its objectives to date.[2] Eliminating that scheme now – either through legislation or administrative action – would likely induce some non-bank financial firms to affirmatively seek out systemic risk in hopes of being bailed out in the future.

Third, my testimony will suggest that, as envisioned in Dodd-Frank, FIO can and should work with state insurance regulators to coordinate the United States' position in international negotiations and standard setting organizations. Federal involvement in the international insurance context is vital both because of the prominence of systemic risk issues in this setting and because of federal actors' unique capacity to craft a unified U.S. position on insurance matters.

However, proposals requiring FIO to reach a consensus with state insurance regulators on international matters, limiting its capacity to support international standards that would move U.S. insurance regulation forward, or mandating that it consult with Congress throughout international negotiations, are deeply problematic. These reforms would effectively give a single state veto power with respect to international insurance matters. More generally, they would undermine federal actors' realistic capacity to

[2] See Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Non-Bank Problem*, 84 U. Chi. L. Rev. (forthcoming, 2017).

meaningfully engage with the international community in the insurance domain. The predictable result of these unprecedented rules would be that the international community would move forward in the development of international standards without the U.S. playing a meaningful role in that process.

(1) FIO plays an important role in monitoring the state regulatory system and efforts to weaken its already limited authority, resources, and independence are therefore misguided.

(a) <u>As a historical matter, federal scrutiny has dramatically influenced and improved state insurance regulation.</u>

Ever since the Supreme Court held that Congress has the power to regulate insurance markets, the federal government has played a vital role in monitoring and indirectly shaping state insurance regulation.[3] Indeed, only one year after the Supreme Court's holding, Congress exempted the insurance industry from most federal antitrust laws on the condition that the states adopt – as President Roosevelt explained in his signing statement of the law – "actual regulation of rates by affirmative action of the states."[4] This federal condition was itself driven by a Department of Justice report concluding that many state insurance regulators tolerated explicit price fixing schemes among insurers.

[3] Numerous experts on the history of state insurance regulation have made similar observations. See, e.g., Kenneth Meier, Political Economy of Regulation: The Case Of Insurance 51-54 (1988); Daniel Schwarcz, *Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection*, 61 UCLA L. Rev. 394, 457-58 (2014); Bipartisan Policy Center, Improving US Insurance Regulation (2017).

[4] Meier, supra, at 51-54. The McCarran Ferguson Act itself only requires states to "regulate the business of insurance." But as President Roosevelt's signing statement confirms, this phrase was understood at the time to focus on rate regulation, a sentiment that helps explain why states uniformly adopted the ubiquitous prohibition on "excessive, inadequate, or unfairly discriminatory" rates in insurance.

States responded to these federal pressures by implementing a robust system of insurance rate regulation and ultimately limiting competing insurers' capacity to fix rates.[5]

In the decades since the McCarran Ferguson Act's passage, federal scrutiny of state insurance regulation has continued to prompt many of the most important advances in state insurance regulation. Consider, for instance, the state-based system of solvency regulation, which is often described as the most effective component of the state insurance regulatory system. Until the early 1990s, state solvency regulation was both inconsistent across different states and remarkably ineffective. States maintained widely divergent capital and reserve rules, and they largely ignored fundamental techniques of prudential regulation, such as risk-based capital requirements. It was not until the early 1990s, after a series of high-profile insurer failures prompted a scathing congressional report entitled "Failed Promises"[6] along with a bevy of Congressional proposals to federalize insurance regulation, that state insurance regulators developed the core pillars of modern solvency regulation. Acting in direct response to these federal pressures, states coordinated through the National Association of Insurance Commissioners (NAIC) to develop risk-based capital requirements and an accreditation scheme that promotes uniform and coordinated solvency monitoring and enforcement.

Another key element of state solvency regulation – guarantee funds, which protect policyholders from the risk that their carrier will be financially unable to pay claims – also was implemented by states in direct response to federal scrutiny. Prompted by a series of insurer insolvencies that had left policyholders without their promised insurance

[5] Daniel Schwarcz, *Ending Public Utility Style Rate Regulation in Insurance*, 35 Yale J. Reg. (forthcoming, 2018).
[6] Subcomm. on Oversight & Investigations of Comm. on Energy & Commerce, 101st Cong., Failed Promises: Insurance Company Insolvencies (Comm. Print 1990)

benefits, legislation was introduced in Congress in 1969 to create a federal property/casualty insurance guaranty fund. The legislation was never passed, in large part because it triggered concerted efforts among state regulators and lawmakers to remedy the underlying problem. The NAIC promptly developed a model law establishing property/casualty guaranty funds and, within the span of only a few years, nearly every state adopted the model act.[7] The resulting system of state guarantee funds continues to this day to do a reasonably good job of protecting policyholders from the risk that their insurer will become insolvent.

State reforms in the face of specific and overt federal pressure have not only improved the effectiveness of insurance regulation, but have also increased its efficiency. For instance, certain large property/casualty and life insurers had long complained about the inefficiencies of state policy form regulation. But it was only when these carriers began to back federal legislation to create an Optional Federal Charter in the early 2000s that states began to take meaningful steps to improve the efficiency of state review of policy forms.[8] These efforts included initiatives such as the Interstate Insurance Product Regulatory Commission and the State Electronic Rate and Form Filing system. Similarly, states only started to take concrete steps to coordinate producer licensing standards in response to a direct preemption threat contained within the Gramm-Leach Bliley Act, which required the creation of a national scheme for producer licensing if states did not act.

Many more examples could be given of state reforms that were prompted by direct federal scrutiny and criticism of state insurance regulation. But the point should now be

[7] Robert Klein, Issues Concerning State Guarantee Funds (1992).
[8] See Terri Vaughan, *The NAIC's 2002 Agenda: Toward a More Efficient System of Insurance Regulation*, 20 J. Ins. Reg. 251 (2002).

clear: state insurance regulation as it exists today is fundamentally a product of periodic federal scrutiny, which has consistently proven to be the key catalyst in prompting states to remedy gaps, deficiencies or inefficiencies in their insurance regulatory regime.

(b) Through the creation of the Federal Insurance Office, the Dodd-Frank Act helped systematize and enhance federal scrutiny of state insurance regulation.

Although federal scrutiny has historically played a foundational role in prompting positive changes in state insurance regulation, such scrutiny was itself generally driven either by high-profile scandals or concerted industry-driven lobbying efforts. This system for triggering state insurance reforms is hardly ideal. Regulatory systems should, to the extent possible, anticipate and correct market problems or regulatory deficiencies before they result in scandal. And while insurers and other insurance-industry groups have the resources and clout to generate federal scrutiny of inefficient state regulatory practices, policyholders and public interest groups have no similar realistic capacity to place their insurance-regulatory concerns on the federal agenda.

The Dodd-Frank Act helped to systematize and enhance federal monitoring of state insurance regulation with the establishment of the Federal Insurance Office ("FIO") within the U.S. Treasury Department. FIO does not have any regulatory powers. Instead, Dodd-Frank directed FIO to monitor "all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers." It also instructed the office to assess "the extent to which traditionally underserved communities and consumers, minorities... and low- and moderate-income persons have access to affordable insurance products." 31 U.S.C.A. § 313. To help FIO achieve these objectives, Dodd-Frank granted the office certain information-gathering authorities, including the authority to collect data directly from insurers. Dodd-Frank also required FIO to make annual reports to Congress and to conduct a study on how to modernize and improve state insurance regulation.

Over the last several years, FIO has proven effective in identifying shortcomings in state insurance regulation and prompting potential state regulatory reforms. Consider just one example: FIO has consistently recommended that state regulators reform their treatment of captive reinsurance transactions.[9] In these transactions, an insurer purchases reinsurance from an affiliated company that is subject to more limited regulatory scrutiny because it is organized as a "captive insurer" rather than an ordinary insurer. States long permitted this regulatory arbitrage, even though it made insurers' risk profiles deeply opaque due to the limited transparency of reinsurance captives' balance sheets.[10] In the face of targeted criticism by FIO – as well as the New York Insurance Department and the Financial Stability Oversight Council – states have adopted some important reforms of these transactions, while continuing to consider additional necessary improvements.

Of course, the causal link between FIO scrutiny and any specific state insurance reform effort, such as captive reinsurance, is impossible to prove. But any fair observer of state insurance regulation over the last handful of years would grant that FIO's reports and criticisms have undoubtedly influenced state reforms on a broad array of issues, ranging from group supervision, to insurance affordability, to coordination of market conduct supervision.

(c) <u>Recent reform proposals would dramatically undermine the Federal Insurance Office's capacity to monitor state insurance regulation.</u>

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[9] See Federal Insurance Office, How to Modernize and Improve the System of Insurance Regulation in the United States (2013).
[10] See Daniel Schwarcz, *The Risks of Shadow Insurance*, 50 Ga. L. Rev. 163 (2015).

The proposed Federal Insurance Office Reform Act of 2017, H.R. 3861, would dramatically reduce FIO's capacity to effectively monitor state insurance regulation, thereby undermining healthy federal scrutiny and criticism of that system. First, the Act would constrain FIO's authorities and resources, even though the office already enjoys extremely limited powers under Dodd-Frank and includes a small staff that consumes few resources. The Bill would limit the office to not more than 5 specific personnel; it would eliminate FIO's capacity to collect, analyze, or disseminate data in any manner other than through an information-sharing agreement; it would limit its capacity to produce reports; and it would jettison the FIO Director's authority to advise the secretary on major domestic insurance issues.

The proposal to eliminate FIO's data collection powers is particularly noteworthy in light of the office's mandate to study insurance affordability issues. In a recent report, FIO found that minimum required levels of auto insurance were unaffordable in approximately 9% of zip codes with substantial minority or low- or moderate- income populations, areas that together include over 18 million people.[11] However, data limitations prevented FIO from assessing the causes of these affordability problems in individual zip codes, the extent to which they differentially impacted sub-populations, or whether individual insurers were disproportionately contributing to these issues. State insurance regulators nonetheless recently abandoned a proposal to collect data on individual insurers that would facilitate analysis of these issues.[12] It is precisely when

[11] See Federal insurance Office, Auto Affordability Study (2017).

[12] The backstory of this development helps illustrate why robust federal scrutiny of state insurance regulation is necessary. In 2012, shortly after Dodd-Frank's passage, the NAIC created an Auto Study Working Group to study the issue of insurance affordability. After years of inaction, members of the Working Group finally concluded that understanding the scope and causes of insurance affordability problems required them to collect granular data with respect to individual insurers' auto insurance premiums and claims rates. The committee eventually developed a detailed data call, which it exposed for

state insurance regulators are unwilling to collect the data necessary to assess matters of national importance that FIO can and should use its data collection authority.

In addition to undermining FIO's authorities and resources, the Bill would limit FIO's independence from state regulators. For instance, it would require FIO to "achieve consensus among the states" in coordinating federal international insurance policy and other matters of international importance. Although this provision is oriented towards international affairs, it would limit FIO's realistic capacity to challenge state insurance regulators in any domain, lest FIO find itself unable to move ahead on its international responsibilities.

By diminishing FIO's authorities, capabilities, and independence, H.R. 3861 would shield state insurance regulation and the NAIC from the systematic and consistent federal scrutiny that they have faced since the passage of Dodd-Frank. Although individual state insurance regulators may enjoy this reprieve from informed and expert scrutiny, the system of state insurance regulation would ultimately suffer as a result. Reduced federal scrutiny would ultimately mean reduced pressure on state insurance regulators to proactively identify and respond to regulatory gaps and inefficiencies. Defenders of the state insurance regulatory system should welcome such scrutiny and acknowledge the foundational role it has played in the evolution of state insurance

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comments and refined with the benefit of input from numerous stakeholders. During the most recent NAIC national meeting, however, the Working Group suddenly, and without meaningful prior notice, abandoned its proposed data call in favor of an industry-crafted proposal. That proposal requires insurers, through statistical agents, to report only aggregate industry data, which is designed to facilitate ratemaking review rather than to facilitate the investigation of affordability questions. Aggregated industry data, of course, eliminates regulators' capacity to determine whether a subset of individual insurers' practices disproportionately contribute to affordability problems. It also undermines regulators' capacity to verify the data for completeness or accuracy or assess what percentage of individual markets are served by non-standard carriers. And these problems with the industry data collection proposal are just the tip of the iceberg. For a more complete description of these problems with the NAIC Auto Study Working Group process, see Letter from Consumers Union, Consumer Federation of America, and Center for Economic Justice to Ted Nickel, President of the National Association of Insurance Commissioners (9/5/17), available at http://consumerfed.org/wp-content/uploads/2017/09/cu_cfa_cej_naicletter_autoaffordability_170905.pdf regulation. Unfortunately, the proposed Federal Insurance Office Reform Act of 2017, H.R. 3861, would do exactly the opposite.

(2) The federal government has a special responsibility to monitor, and where necessary supplement, state insurance regulation with respect to the regulation of systemic risk.

(a) <u>Non-bank financial companies such as insurers can pose systemic risks to the broader financial system.</u>

As exemplified by the dramatic failures of American International Group ("AIG") and various financial guarantee insurers, as well as the temporary but severe capital shortfalls of large life insurance companies that had issued long-term guarantees to policyholders, insurance companies and their affiliates played a central role in the 2008 financial crisis. Despite these facts, a narrative has emerged in certain policy circles over the last several years that insurers are not, in fact, systemically risky. This argument emphasizes that very few traditional insurers actually failed during the financial crisis. It also stresses that AIG Financial Products – the division of AIG that was principally responsible for writing the Credit Default Swaps (CDSs) that were an important source of the company's problems – was not actually an insurance company. Finally, and perhaps most prominently, it emphasizes that insurers, unlike banks, do not have a mismatch in their assets and liabilities that can make them susceptible to run-like dynamics.

But commentators who dismiss systemic risk in the insurance industry misunderstand the nature of AIG's collapse in 2008 and ignore broader linkages between the insurance industry and the rest of the financial system. First, AIG's failure in 2008 was just as much a failure of the firm's insurance operations as its derivatives business.

It is true that one of the primary causes of the firm's failure was its CDS operations. But an equally important cause of AIG's collapse was the company's ill-fated securities lending program, under which it lent out the assets of its insurers to large financial institutions in exchange for cash collateral, which it then invested in mortgage backed securities.[13] These securities lending contracts were very short-term, thus allowing spooked counterparties to quickly demand a return of their cash collateral. Unlike CDSs, securities lending operations are common among life insurers, and deeply intertwined with the broader nature of life insurance operations, which generally require insurers to own long-term securities that can profitably be lent out to other actors within the financial system.

More generally, while it is certainly true that experts continue to disagree about how systemically risky insurance companies are at present, an emerging consensus exists that insurance-focused firms are indeed structurally capable of posing a variety of systemic risks to the larger financial system.[14] There are several basic explanations for these conclusions. First, insurers are among the largest and most important institutional investors domestically and internationally. They own approximately one-third of all investment-grade bonds and, collectively, own almost twice as much in foreign,

[13] See Anna Paulson & Robert McDonald, *AIG in Hindsight*, 29 J. Econ. Persp. 81 (2015).
[14] See, e.g., Ralph S. Koijen & Motohiro Yogo, Risk of Life Insurers: Recent Trends and Transmission Mechanisms, in The Economics, Regulation, and Systemic Risk of Insurance Markets (2016); Viral Acharya, Thomas Philippon, and Matthew Richardson, Measuring Systemic Risk for Insurance Companies (2016), in Systemic Risk of Insurance Markets, supra; Anna Paulson and Richard Rosen, Measuring Interest Rate Risk in the Life Insurance Sector: The US and the UK (2016), in Systemic Risk of Insurance Markets, supra; Daniel Schwarcz & Steven Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. Chi. L. Rev. 1569 (2014); J. David Cummins & Mary A. Weiss, *Systemic Risk and the U.S. Insurance Sector*, 81 J. Risk & Ins. 489 (2014); Scott Harrington, *The Financial Crisis, Systemic Risk, and the Future of Insurance Regulation*, 76 J. Risk & Ins. 785 (2009); Monica Billio, Mila Getmansky, Andrew W. Loc, & Loriana Pelizzona, *Econometric Measures of Connectedness and Systemic Risk in the Finance and Insurance Sectors*, 104 J Fin. Econ. 535 (2012); Faisal Baluch, Stanley Mutenga & Chris Parsons Baluch, *Insurance, Systemic Risk and the Financial Crisis*, 36 The Geneva Papers 126 (2011); Viral Acharya, Lasse Heje Pedersen, Thomas Philippon, & Matthew P. Richardson, *Measuring Systemic Risk* (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1573171.

corporate, and municipal bonds than do banks. Insurers' massive role as investors means that they can pose systemic risks by triggering or exacerbating "fire sales" of specific securities or types of securities. Second, such fire sales could themselves be triggered by a variety of mechanisms. As AIG demonstrated, certain life insurer activities, like securities lending and derivatives trading, can create sudden liquidity needs. Moreover, many life insurance products, such as Guaranteed Investment Contracts, funding agreements, and certain annuity products entitle policyholders to withdraw funds on demand, creating the prospect of runs that are analogous to bank runs.[15] Abrupt changes in regulatory or accounting rules could also conceivably trigger a fire sale among insurers, as could a wide-spread catastrophe, particularly if any of these occurred in the midst of broader financial instability.

There can thus be little doubt that the collapse of an insurance giant could in the future threaten the stability of the broader financial system and economy, just as the collapse of AIG did in 2008. Perhaps even more troublingly, the risk of this outcome is in some ways larger now than it was before the crisis. Although necessary to save the financial system, the bailouts of AIG and other nonbank financial firms only cemented the understanding of market actors that the federal government will ultimately have no choice but to bailout systemically significant nonbank financial firms in a panic. This understanding, in turn, may affirmatively incentivize insurers and other non-bank financial firms to become systemically risky so as to benefit from this implicit government backstop.

(b) State insurance regulators face legal, political, and structural barriers to regulating systemic risk in insurance.

[15] See Chicago Fed Letter, How liquid are U.S. life insurance liabilities? (2012).

State insurance regulators do a commendable job of regulating insurance companies for solvency concerns. But this regulatory objective is importantly different from the goal of preventing systemic risk. Solvency regulation is ultimately driven by the goal of protecting policyholders, whereas systemic risk regulation is driven by the objective of limiting the possibility that insurance activities or failures could contribute to financial instability. Only the federal government has the appropriate political accountability and line of sight into the entire financial regulatory system to effectively police this broader, macro-prudential risk.

In the insurance setting, the most important practical difference between solvency regulation and systemic risk regulation is the object of regulatory oversight. Solvency regulation can be effectively directed at individual legal entities within a larger financial conglomerate, so long as regulators carefully scrutinize transactions among legal entities and their affiliates or holding companies. This is the fundamental premise of state insurance regulation, which focuses almost exclusively on individual legal entities. Indeed, every core element of state insurance regulation – including risk-based capital rules, reserve requirements, licensing requirements, investment restrictions, and financial monitoring – is applied solely to individual operating insurers.[16]

By contrast, broad consensus exists across the international community that effective systemic risk regulation requires both supervision and prudential rules that are directed

[16] To illustrate, at the end of 2014, MetLife included 359 subsidiaries in 50 different countries. Many of these subsidiaries operated within the United States, and only a subset of these subsidiaries were licensed insurance companies that were subject to state insurance regulation. These individual insurance entities, moreover, were regulated by numerous different states, including New York, Connecticut, Delaware, Rhode Island, and Missouri. All of the traditional tools of state solvency regulation were independently directed at each of these insurance entities, rather than the consolidated MetLife enterprise. See Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc. (Dec. 18, 2014).

across an entire financial conglomerate.[17] In other words, to the extent that an insurance-focused firm is systemically risky, then effective regulation requires evaluating it holistically and applying the core tools of prudential regulation, such as risk-based capital requirements, to the financial conglomerate as a whole. It is for precisely these reasons that banking regulation—where systemic risk has long been a core regulatory concern—explicitly extends to both individual banks and their holding companies.

State insurance regulation is simply not capable of providing the group-level regulatory scrutiny of financial conglomerates that systemic risk regulation demands. First, state insurance regulation imposes no quantitative restrictions, such as group capital requirements, on consolidated financial conglomerates. Instead, group supervision by state insurance regulators relies exclusively on supervisory colleges and working groups, which depend on regulators effectively using their discretion to identify problems.[18] Second, state insurance regulators generally lack meaningful legal authority over insurance holding companies or their non-insurance subsidiaries.[19] Third, state insurance

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[17] See Basel Committee, Principles for the Supervision of Financial Conglomerates 3 (2011) (discussing the importance of group-level supervision in addition to entity supervision for the regulation of large financial conglomerates); International Association of Insurance Supervisors (IAIS) Core Principles 23 (describing as a core principle of insurance regulation that "[t]he supervisor supervises insurers on a legal entity and group-wide basis."); FSOC Final Rule, 77 Fed. Reg. 21660 (Apr. 11, 2012) (codified at 12 C.F.R. Pt. 1310) (providing that FSOC will evaluate the "[e]xistence and effectiveness of consolidated supervision" in determining whether a nonbank financial firm could pose a systemic risk to the broader financial system).
[18] See Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U Cal. Irvine L. Rev. 537 (2015); Patricia A. McCoy, *Systemic Risk Oversight and the Shifting Balance of State and Federal Authority Over Insurance,* 5 U. Cal. Irvine L. Rev. 1389 (2015).
[19] In general, state commissioners can only compel insurance subsidiaries to submit reports, not parent companies or non-insurance affiliates. The one exception is that, under the Model Holding Company Act, states can indeed demand that parent companies file an enterprise risk report. See NAIC, Model #440, Insurance Holding Company System Regulatory Act § 4L. But even in the case of this limited exception, state insurance regulators have no enforcement authority over the parent itself. Instead, their sole enforcement authority for a parent's noncompliance with this single requirement comes under § 11F, which permits regulators to disapprove dividends or distributions or to place an order of supervision on the insurance subsidiary. For these reasons, insurance subsidiaries must rely on the kindness of their parent companies and affiliates to obtain information about transactions and exposures through the group. Since much of this data collection is voluntary, it comes as no surprise that insurance regulators do not systemically collect consolidated group-wide data on insurance firms. See Patricia A. McCoy, *Systemic*

regulators cannot monitor the exposures of non-insurance firms (like investment banks, commercial banks, and hedge funds) to insurance groups, because they lack access to information about other firms' exposures to insurance groups, as well as the expertise, budget, and staff to monitor those interconnections successfully.

State actors' local political accountability also limits the extent to which they can be relied on to regulate systemic risk in insurance. The core problem is that state insurance regulators are either directly or indirectly politically accountable only to the constituents in their jurisdictions. But the benefits of reducing systemic risk are felt almost entirely outside of the boundaries of any individual state. For this reason, systemic risk regulation should generally be conducted at the national and international levels.

In light of these considerations, it is hardly surprising that international bodies have repeatedly expressed concern about the capacity of states to regulate large financial conglomerates that may pose systemic risks. For instance, a peer review of the U.S. state-based system of insurance regulation by the Financial Stability Board concluded "that while the state-based regulatory system was effective in assuring policyholder protection and the soundness of individual insurance companies, it lacked a systemic focus and the capacity to exercise group-wide oversight."[20] Similarly, a report of the International Monetary Fund noted that international regulatory regimes have increasingly "been supplementing their strong solo company focus with financial and other requirements and

Risk Oversight and the Shifting Balance of State and Federal Authority Over Insurance, 5 U. Cal. Irvine L. Rev. 1389 (2015). More generally, state insurance commissioners lack authority to sanction insurance group parent companies or non-insurer affiliates for any activities that jeopardize their insurance affiliates or threaten systemic harm to outside financial firms. Instead, state regulators can only hope to achieve such enforcement indirectly by imposing sanctions on the insurance subsidiaries that they do regulate. Needless to say, these jurisdictional impediments are magnified when an insurance subsidiary is domiciled in one state and its holding company is incorporated in another state. See id.; Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U Cal. Irvine L. Rev. 537 (2015).

[20] Financial Stability Board, Peer Review of the United States 32 (2013).

more supervisory focus applied at the group level and U.S. supervisors should do the same."[21]

These concerns are not simply theoretical: state insurance regulators' lack of adequate group regulation was partially responsible for AIG's collapse in 2008.[22] As described above, AIG's failure was attributable to both the firm's CDS business and its securities lending operations. Although state regulators did not have jurisdiction over AIG's CDS operations, the firm's securities lending operations directly implicated its insurers, whose assets were used to sustain the program. Yet "prior to mid-2007, state regulators had not identified losses in the securities lending program and the lead life insurance regulator had reviewed the program without major concerns."[23] State insurance regulators failed to diagnose these problems with AIG's securities lending program because it was operated by non-insurer affiliates of the company. As a result, no individual insurance regulator took primary responsibility for carefully scrutinizing that program.[24] Just as importantly,

[21] International Monetary Fund, United States: Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of IAIS Insurance Core Principles (2010) (noting that

[22] To be sure, federal regulators also had jurisdiction over AIG and failed to prevent its collapse. The explanation for this failure was that federal financial regulation before the crisis was structured so as to allow firms like AIG to "shop" for their preferred regulator. AIG exploited this system to select the U.S. Office of Thrift Supervision (OTS) as its consolidated regulator. The OTS had a reputation for being a lax regulator, particularly with respect to non-banking products and services, for which the agency lacked expertise. See Gov't Accountability Office, Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration (2007) (describing the OTS's relative lack of expertise in supervising financial activities that did not involve activities traditionally engaged in by thrifts, such as credit default swaps); Causes of the Recent Financial and Economic Crisis, Before the Fin. Crisis Inquiry Comm'n, (Sept. 2, 2010) (statement of Chairman Ben S. Bernanke) (noting that OTS's supervision of AIG's derivatives activities in its financial-products unit was extremely limited in practice). Dodd-Frank responded to these problems both by eliminating OTS as well as the federal regulatory architecture that allowed firms to select their consolidated regulator. See Kathleen C. Engel & Patricia A. McCoy, The Subprime Virus (2011).

[23] U.S. Gov't Accountability Office, GAO-11-616, Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc. 13 (Sept. 2011).

[24] The Role of Derivatives in the Financial Crisis: Hearing Before the Fin. Crisis Inquiry Commission, 111th Cong. 206 (2010) (testimony of Eric R. Dinallo, Former Superintendent, N.Y. State Ins. Dep't) (admitting that AIG's securities-lending operations "le[d] to . . . regulatory assignment questions"); *See* Federal Insurance Office, How to Modernize and Improve the System of Insurance Regulation in the

state insurance regulators' focus on individual insurance entities also caused them to miss the key fact that the risks associated with AIG's securities lending program were the exact same risks being taken by the company's financial products subsidiary.[25]

In sum, state insurance regulation faces substantial structural limitations in its capacity to regulate systemic risk in the business of insurance. These limitations help explain why state insurance regulators failed to prevent the collapse of AIG in the 2008 crisis. And they also help to explain why the international community has consistently expressed concern about the effectiveness of the state-based system of insurance regulation in the United States with respect to group supervision.

(c) Through both FIO and the FSOC designation scheme, federal actors help supplement state insurance regulation so as to help limit the prospect that systemic risk could build up in this sector of the financial system.

Given the limitations of state insurance regulation in policing against systemic risk, the federal government has a particularly vital role to play in monitoring for the buildup of such risk and proactively seeking to prevent it. As described above, this is one of the core missions that Dodd-Frank gives to FIO. Indeed, the very first responsibility that FIO is entrusted with under the statute is to identify "issues or gaps in the regulation of insurers that could contribute to a systemic crisis."

But Dodd-Frank's primary approach to preventing systemic risk in the insurance industry is to task the Financial Stability Oversight Council ("FSOC") with responsibility for identifying systemically risky nonbank financial firms. This power of the council,

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United States 40 (2013) (noting that the "inability of [state regulators' solo entity focus] to account for consolidated supervision was evident during the financial crisis, particularly in the case of AIG").

[25] See Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U Cal. Irvine L. Rev. 537 (2015).

although it has only been utilized four times, has occasioned considerable controversy in court, in Congress, and among commentators. These critics typically assume that the core purpose of FSOC designation is to accurately and consistently identify non-bank financial firms whose collapse would threaten the financial system. And they often imply that FSOC can only accomplish this by developing a detailed and analytically complete account of what factors render a non-bank financial firm systemically suspect, complete with a quantified and comprehensive cost-benefit analysis conducted in the course of any particular designation. The council's designation decisions look less like these critics' preferred sort of precise determination, and more like an inference, based on a range of factors and evidence, that material financial distress at targeted firms "could" contribute to broader financial instability.[26]

These criticisms miss the mark because they ignore the reality that the distinction between non-bank firms that are systemically significant and those that are not is, at this point, inherently murky and indeterminate. Although broad consensus exists on many of the relevant factors for assessing whether an individual non-bank firm is systemically significant, it is impossible to predict with any modicum of certainty how any single firm's financial distress or range of activities might reverberate throughout the broader financial system in some hypothetical, future, financially-stressed world.

The FSOC designation scheme nonetheless helps prevent insurance firms from becoming systemically risky by deterring them from seeking out systemic risk in the first place.[27] FSOC's refusal to reduce designation (or de-designation) to a simple formula

[26] See, e.g., Report of The Republican Staff of The House Financial Services Committee, The Arbitrary and Inconsistent FSOC Designation Process (2017).
[27] See Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Non-Bank Problem*, 84 U. Chi. L. Rev. (forthcoming, 2017).

means that firms that come too close to being plausibly systemically risky face the prospect of designation, and the "enhanced supervision and prudential standards" that come along with it. This, in turn, deters most insurers and other non-bank firms from treading too closely to the systemic risk line, as evidenced by the actions of firms that have been designated as systemically significant to date. Although the amorphous nature of FSOC's designation regime creates uncertainty for some firms on the borderline of systemic risk designation, this is a necessary downside of an FSOC regime whose primary goal is not to correctly identify every systemically significant non-bank firm, but is instead to reliably prevent most non-bank firms from taking on the pre-crisis systemic risk profiles of firms like AIG, Lehman Brothers, or Bear Stearns.[28]

To be sure, systemic risk in insurance can also arise outside of individual institutions due to activities that take place across segments of the industry, but are not localized at any particular firm.[29] As such, FSOC can and should employ an activities-based approach in identifying and responding to systemic risk in insurance. But an activities-based approach is not mutually exclusive with the FSOC regime for designating individual firms.

[28] FSOC's recent de-designation of AIG is notable in this respect. As found by the requisite two-thirds of FSOC's voting members, AIG is a significantly less risky company now than it was in past years. See Financial Stability Oversight Council, Views of Financial Stability Oversight Council Members Regarding Rescission of Determination Regarding American International Group, Inc. (AIG) (2017). Notably, though, several of the voting members of FSOC that supported de-designating AIG also acknowledged the importance of continued federal monitoring of the company for systemic risk concerns. See Opinion of Independent Member Roy Woodall ("I do believe [that AIG] should continue to be monitored from a macro-prudential perspective."); Statement of Janet Yellen on the Financial Stability Oversight Council's decision to rescind the designation of American International Group (AIG) as a systemic nonbank financial company ("It is important to continue to monitor large nonbank financial firms to ensure that, should they encounter distress, the functioning of the broader economy is not threatened.").

[29] See Daniel Schwarcz & Steven Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. Chi. L. Rev. 1569 (2014) (arguing that "Dodd-Frank largely overlooked a second, and equally important, potential source of systemic risk in insurance: the prospect that correlations among individual insurance companies could contribute to or cause widespread financial instability.").

To the contrary, an activities-based approach to systemic risk in insurance is complementary to FSOC's designation of individual firms, for two reasons. First, the two approaches deal with different risks: even if no individual activity in which insurers engage can appropriately be deemed systemically significant on its own, it is possible for an individual insurance firm to be systemically significant. This is because a firm's risk profile is a product of the inter-relationships of the firm's various activities. To illustrate, AIG did not fail solely because of its CDS business or its securities lending operations. Instead, it failed because these two activities posed the exact same risk to AIG: that mortgage-backed securities would drop precipitously in value and become deeply illiquid. An activities-based approach to systemic risk regulation is not attuned to this type of concern, which is fundamentally about how the various activities within an individual institution can interact with one another, rather than the inherent riskiness of any individual activity when considered in isolation.

Second, FSOC's capacity to promote regulatory reform with respect to insurance activities depends, as a practical matter, on its power to designate individual firms as systemically significant. Under Dodd-Frank, FSOC cannot set supervisory priorities for member agencies or develop new or revised regulations regarding activities or practices that are under their jurisdiction. Instead, FSOC simply has persuasive authority with respect to these key elements of the financial regulatory universe. For instance, FSOC can "recommend" that member agencies apply "new or heightened standards and safeguards for financial activities or practices that could" generate systemic risk. But member agencies need not accept these recommendations, so long as they provide an explanation for their decision.

For these reasons, FSOC's practical capacity to induce primary financial regulators, such as state insurance regulators, to address activities-based systemic risk concerns depends on it being able to designate as systemically significant the firms that are within those regulators' jurisdiction. Even though FSOC designation does not strip a primary regulator of its authority over a designated firm, it no doubt diminishes the authority and power of that primary regulator, thereby intruding on its regulatory turf.[30] Moreover, FSOC would have good reason to respond to a primary financial regulator's refusal to adopt its recommendations by designating some of the firms that the regulator oversees. This is because "existing regulatory scrutiny" is one key factor in considering whether an individual firm is systemically risky. Thus, it would stand to reason that a primary financial regulator's refusal to accept an FSOC recommendation would increase the potential for the firms overseen by that regulator to be deemed systemically significant.

This capacity of FSOC's designation power to incentivize regulators to better account for systemic risk is perfectly illustrated by FSOC's successful campaign to induce the SEC to reform its regulation of money market funds. Several years ago, the SEC opposed new regulations of money market funds that a significant majority of FSOC deemed vital to preventing systemic risk. Eventually, the SEC relented and adopted these important reforms to money-market mutual funds. They did so, however, only after the Council had explicitly threatened the SEC with the prospect of designating large money market funds and their advisors as systemically significant.[31] In other words,

[30] See Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Non-Bank Problem,* 84 U. Chi. L. Rev. (forthcoming, 2017).
[31] As the minutes to a 2012 FSOC meeting on money market funds indicated, the Treasury Secretary "urged the Council to take parallel steps to consider authorities under Title I ... of the Dodd-Frank Act in

FSOC was only able to implement an important activities-based reform as a result of its capacity to designate individual firms should these reforms not be adopted. Eliminating FSOC's ability to designate individual systemically significant firms would thus also undermine the Council's ability to promote activities-based reforms.

(3) Proposals requiring FIO to reach a consensus with state insurance regulators on international matters, limiting its capacity to support international standards that would move U.S. insurance regulation forward, or mandating that it consult with Congress throughout international negotiations are deeply problematic.

(a) <u>The federal government, through FIO, should – in coordination with state insurance regulators – play a primary role in representing the U.S. in the international arena.</u>

One of FIO's most important roles under Dodd-Frank is to "coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors." 31 U.S.C. § 313. Dodd-Frank also directs FIO to assist in the negotiation of "covered agreements," which are agreements with other countries "regarding prudential measures with respect to the business of insurance or reinsurance."

FIO's central role in coordinating federal policy in the international domain is appropriate for two reasons. First, as explained more fully earlier in my testimony, the federal government has a uniquely important role to play in the insurance regulatory domain with respect to systemic risk issues, which transcend state and national

the event that the SEC is unwilling to act in a timely and effective manner." See Minutes of The Financial Stability Oversight Council (9/28/12).

boundaries and require broad financial market expertise. Systemic risk is one of the most important issues in the international insurance arena precisely because this risk cannot be reliably contained in any particular country, especially given the international reach of many of the biggest insurance-focused firms. It follows naturally that federal actors should play a major role in representing the United States' interests in the international domain.

Second, the federal government is well situated to help coordinate and develop a single U.S. position with respect to insurance matters in international settings. Although states do a commendable job of coordinating their activities and efforts at the NAIC, the NAIC itself is not a governmental entity and state insurance regulators frequently disagree among themselves on policy and regulatory matters. Federal actors like FIO can and should work with individual state regulators, the NAIC, and the Fed (which regulates insurance-focused firms that FSOC deems systemically significant) to craft a single, unified U.S. position with respect to key insurance issues that are being negotiated or discussed in the international domain. Moreover, because federal actors are typically the sole representatives of U.S. interests in the international regulatory arena, they enjoy unique credibility and negotiating leverage that cannot be matched by state regulators.

(b) <u>Although proposals to formalize FIO consultation with state insurance regulators are sensible, requirements that FIO reach a "consensus" with state insurance regulators or that it reject any international standards that would advance U.S. insurance regulation are deeply troubling.</u>

Proposals to formalize the role of state insurance regulators in international processes, such as the negotiation of covered agreements, make good sense. At present, FIO's obligation to consult with state regulators in developing international positions is not explicitly defined in federal law. Such coordination and consultation is essential, given that FIO is not itself an insurance regulator. FIO's lack of regulatory authority means not only that it can gain valuable perspective from state insurance regulators, but also that it will have a difficult time committing in the international arena to positions that state insurance regulators predominantly oppose.

But certain legislative proposals would go well beyond merely formalizing the role of state insurance regulators in the international process, and would instead completely undermine the capacity of federal actors – and the United States more generally – to meaningfully engage in the international insurance arena.

First, some proposed reforms would have the effect of making federal actors completely subservient to the states in the development of international insurance positions. For instance, the Federal Insurance Office Reform Act of 2017, H.R. 3861, would require that FIO develop a "consensus" among state insurance regulators with respect to all international positions. This proposal would effectively give a single state veto power on international insurance matters. In fact, states themselves rarely reach consensus with respect to policy and regulatory matters. As such, the provision could effectively limit the U.S. from taking any position on key issues in the international insurance arena. This, of course, would undermine U.S. influence and the capacity of state or federal actors to advance the U.S. insurance agenda internationally.

Second, several reform proposals would affirmatively forbid federal actors from embracing any international position that is not completely consistent with existing state and federal insurance laws. For instance, the International Insurance Standards Act of

2017, H.R. 3762, would prohibit federal actors from agreeing to any position that would be "inconsistent with … Federal and State laws, regulations, and policies on regulation of insurance, including the primacy of policyholder protection in solvency regulation." It would also bar federal actors from acceding to any position "that would not recognize existing Federal and State laws, regulations, and policies on the regulation of insurance as satisfying such proposals."

These proposals are deeply troubling. As discussed above, there are indeed good reasons to believe that systemic risk issues in insurance are not sufficiently addressed by the current state-based system of insurance regulation. Handcuffing federal actors in their international dealings to absolute adherence to the current U.S. system of insurance regulation eliminates the possibility of making any progress in the future on this or related issues. It also effectively announces to the international community that the U.S. is completely unwilling to compromise with respect to any international insurance issue. This approach will predictably lead the international community to simply cut out U.S. actors from the development of international insurance norms and standards.

A third set of proposals – also contained within the International Insurance Standards Act of 2017, H.R. 3762 – undermine federal actors' capacity to engage in the development of international insurance standards by requiring them to report back to Congressional committees before and during the process of developing these standards. These provisions unnecessarily undermine federal actors' capacity to meaningfully negotiate in the international arena. Such negotiation requires parties to be willing and able to adapt over the course of discussions and consideration of differing viewpoints and information. The procedures laid out in H.R. 3762 do exactly the opposite, eliminating the capacity of negotiators to amend their positions or consider compromises without first going through an extensive and unprecedented Congressional approval process. There is a reason why no other federal actor negotiating in the international community is subject to a comparable process of reporting and approval on the development of international standards.

Not only would the unprecedented procedures included in H.R. 3762 undermine the capacity of federal actors to meaningfully engage in the international arena, but they are completely unnecessary to ensure effective legislative oversight in this domain. The IAIS does not make law; it is merely an international standard setting organization. Its principles only have the force of law in the U.S. to the extent that they are affirmatively adopted through ordinary legislative or regulatory processes. To the extent that regulators or lawmakers deem international standards developed at the IAIS to undermine U.S. interests, then they can simply refuse to import them into domestic law.

Testimony of

Katharine L. Wade

Commissioner

Connecticut Insurance Department

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 Federal Government's Role in the Insurance Industry

Thank you Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee. My name is Katharine Wade. I serve as insurance commissioner for the state of Connecticut and as chair of the National Association of Insurance Commissioners' International Relations Committee. I greatly appreciate the opportunity to testify today regarding the appropriate role for the Federal Insurance Office and additional oversight of the federal government's engagement in international insurance issues as well as the NAIC's support for two sensible legislative proposals introduced by Chairman Duffy and Congressman Heck. Chairman Duffy, we appreciate your support for state based insurance regulation and your leadership in working in a bipartisan manner with Congressman Heck on these bills.

The International Insurance Standards Act (H.R. 3762)

The NAIC strongly supports the International Insurance Standards Act of 2017 sponsored by Chairman Duffy and Congressman Heck. The U.S. insurance market is the largest and most competitive in the world. More than 5900 insurers write $2 trillion in premium and employ more than 2.2 million people. State insurance regulators supervise more than a third of all global premium, and taken individually, U.S. states make up 26 of the world's 50 largest insurance markets.

As U.S. state insurance regulators who cooperate closely with non-U.S. jurisdictions 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 remains extensively engaged at the international level to ensure our national state-based system has a prominent voice in the development and implementation of global insurance regulatory principles and standards. As we work with our international counterparts, our objectives are to ensure such standards are adaptable to our markets, and to educate them about our state-based system, including how it functions to protect consumers and evolves by building on its strong track record. While we value the perspective of our international colleagues and have adapted some of their best practices for our own use through the years, we must not allow international discussions to drive changes to our domestic regulatory framework that could potentially disadvantage U.S. policyholders and insurers as well as undermine the strength and stability of our system.

As part of efforts to engage globally, we are committed to working with our federal colleagues, the Federal Reserve and the United States Treasury Department's Federal Insurance Office (FIO), to ensure U.S. interests are appropriately represented. However, it is important to understand their authorities in the insurance sector are more limited than those of the states, which are the primary regulators of the insurance sector. The Federal Reserve regulates depository institution holding companies with insurance operations as well as any insurers designated by the Financial Stability Oversight Council. Importantly, only one U.S. firm that meets the current definition of an Internationally Active Insurance Group (IAIG) is supervised by the Federal Reserve. In the same vein, FIO has no regulatory or supervisory authorities, but we recognize the Treasury Department has an interest in financial stability and the health of our national economy. Therefore, while it is critically important we all work together internationally as part of "Team USA," we must do so with the appropriate recognition of our respective domestic authorities.

While there has been a noticeable and welcome improvement in the relationship and coordination with FIO, this has not always been the case. For the last six years, FIO's involvement in international regulatory standard setting has made it more difficult for U.S. regulators to defend the state-based system and influence the process despite substantial involvement at the International Association of Insurance Supervisors (IAIS). The standards developed by the IAIS continue to reflect a largely European approach to supervision and certain fundamental aspects would not be compatible with the U.S. system despite FIO previously holding several key leadership positions. Furthermore, FIO is not a regulator and does not represent insurance regulators, so its significant involvement in regulatory standard setting up until recently led to a disconnect between our domestic regulatory direction and the international agenda. Similarly, while the Federal Reserve has recently been more measured regarding the nature and substance of its involvement, it has had an outsized role in international regulatory standard-setting discussion, particularly in light of its limited insurance regulatory role in the United States.

Moreover, despite significant efforts to work with federal agencies on international matters, we have historically been disappointed in the lack of depth in the interactions as well as their refusal to include us in international insurance discussions in forums other than the IAIS. In recent years, state regulators have either not been included in critical meetings or relegated to an observer role. For example, the Treasury Department, the Federal Reserve Board and the Securities and Exchange Commission (SEC) are members of the Financial Stability Board (FSB). The FSB has had several discussions regarding insurance matters and drives work streams for the IAIS, yet state regulators have been largely excluded from such deliberations. In recent years, the Treasury's Strategic and Economic Dialogue (S&ED) with China and its successor, the U.S-China Comprehensive Economic Dialogue, as well as the Financial Markets Regulatory Dialogue (FMRD) have not included state regulators, even though our regulatory counterparts from those jurisdictions were included, and in the past state regulators had a role in those meetings.

Given our past experience, we believe it is appropriate for Congress to provide additional oversight of the federal government's engagement on international insurance issues. The International Insurance Standards Act of 2017 does exactly that and addresses many of our longstanding concerns. It requires federal government representatives to include state insurance regulators in any international insurance discussions including those at the FSB relating to insurance. It sets forth formal mechanisms for Congress to conduct oversight and assess the potential impacts of major international insurance agreements on U.S. insurance interests. Importantly, this legislation ensures that when the Federal Reserve and FIO engage internationally on insurance matters, they defend the United States system of insurance regulation, deferring to the judgments of Congress, state legislatures, governors, and U.S. insurance regulators to determine the appropriate regulatory requirements for the U.S. insurance sector.

The legislation addresses several of our concerns with the negotiation and review process for covered agreements. A few weeks ago, the U.S. and EU formally signed the Bilateral Agreement between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance. In conjunction with that agreement, the Treasury and the Office of the United States Trade Representative (USTR) provided a statement of U.S. policy clarifying their interpretation of the covered agreement in key areas like capital, group supervision, reinsurance and the Joint Committee. We worked closely with Treasury and USTR on these clarifications and appreciate their affirmation of the primacy of state regulation. In the months ahead, NAIC members will assess the impact of the covered agreement on state regulation consistent with our open and transparent process, and consider any changes to insurance regulation that may be necessary.

Though we are generally satisfied with the result and it isn't clear future covered agreements will be necessary since the agreement with the EU was the product of fairly unique circumstances, there are several improvements contained within the International Insurance Standards Act that would ensure a smoother process and perhaps better outcomes for the U.S. going forward. First, the legislation requires state insurance regulators be included in any negotiations of a covered agreement. Unfortunately, during the negotiation of the recently signed agreement, only a few regulators were permitted to participate and they could not share information and obtain reactions from the other states until after the agreement was finalized and announced. This made the evaluative process opaque to many of the regulators impacted by it and limited the ability to achieve buy-in from states prior to the conclusion of the negotiations. Second, consistent with its provisions regarding international standard setting, the act prohibits the use of a covered agreement for new prudential regulatory requirements. This ensures the U.S. federal government does not use a covered agreement to import new requirements that are in conflict with the current U.S. regulatory regime. Third, the legislation provides for additional transparency by allowing additional access to negotiating texts, including classified materials for congressional committees, staff with security clearances and International Trade Advisory Committees to the USTR. In this regard, one improvement worth considering is adding more formal mechanisms for stakeholder comment such as requiring the publication of any agreement and the solicitation of comments in the federal register. The current agreement was published in the federal register and the Treasury and USTR convened stakeholder meetings on their own accord, but incorporating such processes into the legislation would guarantee such protocols were followed going forward. Finally, the legislation provides a mechanism for Congress to vote for any proposed agreement. It is odd to require similar approval for other international agreements, but not this one, and for foreign jurisdictions to require the approval by their own legislative bodies, but for the U.S. not to do so.

The Federal Insurance Office Reform Act (H.R. 3861)

The NAIC supports the bipartisan Federal Insurance Office Reform Act. Just as the International Insurance Standards Act increases oversight of FIO's international engagement, it is equally important to ensure FIO's structure and authorities are appropriately tailored to those areas where it can provide the most value. To be clear, the NAIC believes insurance expertise within the Treasury Department or elsewhere within the federal government is necessary given the importance of insurance to our economy. However, a standalone office operating under the imprimatur of its own authorizing statute is not. The roles for which FIO could provide some value (e.g., providing federal insurance expertise, overseeing the Terrorism Risk Insurance Program, coordinating federal agencies as it relates to insurance) can be filled by the Treasury Department without a stand-alone office or agency – indeed, many of these functions were addressed by the Treasury Department before FIO's creation. Some have argued FIO's existence puts pressure on the states to make necessary regulatory improvements. The Treasury Department has a long history of serving as a bully pulpit on regulatory policy without a FIO, but more to the point, the regulatory enhancements that have been made throughout the past nine years were put in place to respond to changes in the insurance market, emerging risks, the evolving impact of technology, and consumer expectations, not because of FIO's presence.

Nevertheless, the bipartisan Federal Insurance Office Reform Act is a step in the right direction, and makes appropriate reforms to the office to ensure it does not stray from its core policy advisory function within the Treasury Department. First, the legislation focuses FIO on international engagement, but makes it clear the office speaks for the Treasury Department and not the states. While, as described above, FIO's involvement internationally has historically complicated our own international engagement in international insurance standard-setting forums such as the IAIS, the Treasury Department clearly has a role to play internationally, particularly as it relates to economic matters. By making clear that FIO represents the Treasury Department and is responsible for coordinating federal agencies' international insurance policymaking, the legislation provides clear lines of demarcation and definition to the role of FIO internationally and domestically. Second, the legislation makes clear that when it comes to engagement internationally, FIO must consult and reach consensus with state insurance regulators, which is critically important in international insurance regulatory standard-setting matters where it is most appropriate to defer to the states as the primary regulators of the sector. Finally, housing FIO where it would most reasonably belong, within the Office of International Affairs, will keep it more focused on its core international mission. Limiting its size ensures the office is refocused on its highest and best use, as a policy office within the Treasury Department and a voice for the federal government on international matters.

The legislation places limits on FIO's information gathering authority. As a general matter, the industry should not be subject to duplicative or burdensome information requests. The NAIC houses the largest insurance database in the world to make certain regulatory functions more efficient and cost-effective for states and therefore consumers. Indeed, the International Monetary Fund referred to the NAIC and state regulators' data analysis capability as "world leading" during the 2010 Financial Sector Assessment Program (FSAP). Importantly, every state insurance department, supported by the NAIC, has comprehensive powers and tools to collect information both from insurers and their affiliates, and we respond to requests for information from federal agencies on a frequent basis. We remain committed to providing the Treasury Department any information they require to carry out their functions. While we continue to believe a standalone FIO is unnecessary, we see this legislation as a positive step towards refocusing the office to areas where it can provide the most value to the federal government and tailoring its size to fit those needs.

State Regulator Vote on FSOC

In addition to these two proposals, we hope the members of the committee will consider providing state insurance regulators a vote on the Financial Stability Oversight Council (FSOC) in a manner consistent with the requirements of the appointments clause of the U.S. Constitution. State insurance regulators are the regulators of the insurance sector, yet are the only primary functional regulators without a vote. State insurance regulators have the necessary expertise and information regarding the sector to inform FSOC's risk monitoring work and help identify any systemic risks that impact the insurance sector. Further, state insurance regulators are the only members of the Council that can commit to take regulatory action across the insurance sector in response to calls for a coordinated approach to address any risks the Council may identify or other relevant regulatory concerns that may arise.[1] A state insurance regulator vote on the Council will only benefit the Council and its important work monitoring the financial stability of the United States.

[1] As previously stated, the Federal Reserve has limited regulatory authority within the insurance sector as they only regulate FSOC designated firms and Depository Institution Holding Companies with insurance operations. Neither the Independent Member with Insurance Expertise nor the Federal Insurance Office has any regulatory authorities over the insurance sector.

Conclusion

In conclusion, the NAIC strongly supports these legislative proposals. They encourage cooperation, clarify the respective roles of FIO, the Federal Reserve, and state insurance regulators, and promote oversight, transparency and inclusion. These improvements will solidify and clarify relationships at home while advancing the interests of the United States in defending our regulatory system, our companies and our citizens abroad.

Thank you for the opportunity to testify today. I look forward to your questions.

//ACLI
Financial Security...for Life.

Statement for the Record

House Committee on Financial Services

Subcommittee on Housing and Insurance

Hearing titled "The Federal Government's Role in the Insurance Industry"

October 24, 2017

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 the federal government's role in the insurance industry.

The American Council of Life Insurers is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, 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 95 percent of industry assets in the United States.

Strength of the State-Based System of Insurance Supervision

The life insurance industry is overseen by a strong State-based system of regulation and supervision. The State-based insurance regime has a long and successful track record of insurance regulation and has protected insurers and policyholders through difficult times, including through the worst aspects of the financial crisis. Insurance companies have experienced prudential regulators that continue to update regulatory and supervisory functions to ensure strong regulation of the industry and strong protections for policyholders. In the last decade, state insurance holding company laws and group supervision practices have been strengthened and expanded to ensure that state regulators are ready to address any issues of prudential concern. Prudential oversight of insurance companies through the State-based system continues to be demonstrably strong and effective as it evolves to meet ongoing challenges. ACLI supports the McCarran-Ferguson Act which forms the legal foundation for the strong State-based system of insurance supervision.

Federal Agencies Should Coordinate with State Insurance Regulators

As the primary prudential regulators of the insurance industry, State insurance regulators have direct supervisory knowledge of insurance markets and are essential to the development of public policy that impacts insurance companies and consumers. Federal agencies should consult with State insurance regulators whenever possible and ensure that State regulators have a seat at the table. As

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an example, the Securities and Exchange Commission (SEC) is now considering possible action on standards of conduct for financial professionals providing investment advice to retail customers. The SEC is consulting with the Department of Labor (DOL) and State insurance regulators as part of this process and should continue to do so throughout any process it may undertake. As the primary prudential regulators for the insurance industry, State insurance regulators have the expertise to ensure that standards of conduct are uniform and harmonized, and provide a high level of protection for consumers. ACLI commends the SEC, DOL, and State insurance regulators for their collective commitment to developing best interest standards that can be consistently and uniformly applied across all regulatory platforms to protect consumers and avoid regulatory arbitrage.

The Federal Insurance Office (FIO) is an Essential Resource

ACLI supports the continued role and mission of the Federal Insurance Office (FIO). Some adjustment to its domestic portfolio may be appropriate, but it should remain an advisory arm to the federal government on insurance issues. At the federal level, FIO is the most comprehensive source of information and expertise on insurance markets. Even though the states are the primary functional regulators of the life insurance industry, the actions of the federal government are increasingly relevant to the industry. FIO is an essential resource for the Treasury Department and for other federal government agencies contemplating policies that may have significant impacts on the life insurance industry. Without FIO, the federal government would be lacking important expertise to understand how its policies impact an industry of the size and scope of the life insurance industry, with $6.8 trillion in assets and 75 million American families as clients.

FIO also protects U.S. competitiveness in international forums. FIO is an essential member of "Team U.S.A." that represents the United States in international forums such as the International Association of Insurance Supervisors (IAIS). Because FIO is part of the U.S. Treasury Department, it is uniquely positioned to strengthen the position and influence of the U.S. in international forums. The participation and engagement of FIO and the other members of Team U.S.A., the Federal Reserve Board and State insurance regulators, are essential to influencing the international process and ensuring that international standards reflect the unique strengths of the U.S. system for prudential insurance regulation. ACLI supports the important work of FIO to ensure a level playing field for U.S. companies and consumers.

ACLI would not support any legislation that disrupts the functions, staffing, and mission of FIO, or that limits its ability to perform its domestic or international responsibilities. Any legislation that impairs the ability of FIO to serve as an expert advisor on insurance matters or represent the U.S. in international forums would be contrary to the interests of U.S. insurance consumers and markets.

U.S. Participation In International Forums Protects U.S. Competitiveness

At the Financial Stability Board (FSB) and the IAIS, Team U.S.A. representatives should work together to defend the U.S. State-based system of insurance supervision. By having a seat at the table and advocating strongly for the U.S. perspective and system, Team U.S.A. can protect U.S. competitiveness and resist proposals that could disadvantage U.S. consumers and companies. ACLI commends Team U.S.A. for coordinating their efforts as part of these forums. By engaging in the process and working together, Team U.S.A. will be best positioned to represent the U.S. and secure the best outcome.

Both Team U.S.A. and Congress should insist on increased transparency, accountability, and due process in these international forums. The ACLI believes that both the FSB and the IAIS should work to improve their engagement with stakeholders and ensure that their governance procedures meet high standards. Highly transparent processes and greater opportunities for stakeholder participation introduce more information, expertise, and experience to the discussion and increase public confidence in institutions. ACLI supports legislation that achieves these goals. However, ACLI would not support legislation that restricts the ability of federal agencies to participate in international forums or impedes their effectiveness. Restricting the role of federal agencies would diminish U.S. influence, constrain our ability to oppose adverse proposals, and increase the likelihood that the U.S. State-based system is not appropriately recognized. Furthermore, ACLI would not support legislation that limits the ability of the covered agreement process to protect the United States from discriminatory regulatory practices and ensure a level playing field for U.S. companies.

Thank you for convening this important hearing and for the opportunity to present the views of ACLI.

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October 24, 2017

The Honorable Sean Duffy, Chairman
Subcommittee on Housing and Insurance
House Financial Services Committee
U.S. House of Representatives
Washington, DC 20515

The Honorable Emmanuel Cleaver, Ranking Member
Subcommittee on Housing and Insurance
House Financial Services Committee
U.S. House of Representatives
Washington, DC 20515

VIA Electronic Mail

RE: Hearing entitled "The Federal Government's Role in the Insurance Industry"

Dear Chairman Duffy and Ranking Member Cleaver:

The American Insurance Association (AIA) writes to express our appreciation for holding the hearing entitled "The Federal Government's Role in the Insurance Industry." AIA represents approximately 325 major U.S. insurance companies that provide all lines of property-casualty insurance to U.S. consumers and businesses, and write more than $127 billion annually in premiums. The balanced roles of state and federal government are crucial in maintaining dynamic and vibrant insurance markets that benefit both policyholders and insurers.

AIA supports the U.S. system of state-based insurance regulation. The regulatory system builds upon (and is consistent with) the insurance industry's strong roots of local engagement with insurance consumers where they live and work. This is particularly true when insurers are called upon to handle claims, at a critical time of individual or business loss. The essential nature of that relationship, grounded in up-front risk analysis and underwriting and post-loss service, defines the insurance business and sets it apart from other purely financial products and services.

At the same time, because companies operate in a 50-state regulatory environment (and beyond for those doing business outside the U.S.), sometimes consistency and uniformity are challenging. In that context, we also recognize the important role of the federal government in representing the U.S. insurance industry in many key areas, including international trade negotiations, before multinational organizations like the Financial Stability Board (FSB) and the

International Association of Insurance Supervisors (IAIS), and with respect to national policy issues that require either a uniform policy approach or a partnership with government. For example, some large-scale risk programs that would not be feasible at the state level, such as the Terrorism Risk Insurance Program and the National Flood Insurance Program, currently require a federal-private partnership to maintain private market stability and growth. For other risks, like cyber insurance, the risk is evolving, and therefore the growth of a private insurance market will follow along with that evolution.

AIA also believes that there is a federal policy role on insurance – short of regulatory authority – to be the eyes, ears, and voice of our national government on insurance issues, working in tandem with state regulators. The very nature of the U.S. 50-state regulatory system means there always will be room for improvement, and a federal office can play an important role in urging state regulation to become more uniform, effective, efficient and appropriately tailored – leveraging its national perspective to facilitate important reforms in tandem with state regulators.

In this regard (and also in connection with engagement on international initiatives), AIA supports the Federal Insurance Office (FIO) in the furtherance of its current duties and as advocates for the U.S. insurance industry. Notwithstanding, consideration should be made on how FIO can be improved and better coordinate with state insurance regulators to achieve positive outcomes and avoid unintended burdens. In order to facilitate this deeper cooperation between state and federal governments, AIA has proposed and supports a state regulatory advisory board consistent with the Dodd-Frank Act, which could be adopted by Treasury. Such a board – to be established in parallel with (not instead of) the Federal Advisory Committee on Insurance (FACI) – could provide a dedicated channel for coordination with state insurance regulators, ensuring that their views are reflected in any policy discussions that occur at the federal level.

As mentioned, AIA also believes there is a critical need for federal officials and the NAIC/state insurance commissioners to be engaged on behalf of the U.S. insurance industry in any international discussions, particularly those involving global regulatory standards/initiatives. While U.S. insurers are subject to regulation at the state level, U.S. representatives (whether those representatives are state commissioners, from the NAIC, Federal Reserve, Treasury, the U.S. Trade Representative (USTR), Department of Commerce, or FIO) must speak with one cohesive and coherent voice in international discussions.

Specifically, FIO's federal voice – frequently in conjunction with the U.S. Trade Representative, the Department of Commerce, Treasury International Affairs, state commissioners, and NAIC staff - has been important in communicating bilaterally with foreign national governments regarding regulatory issues that can have a significant impact on U.S. insurer access to foreign markets. AIA believes that it is essential that the federal government continue to have a voice through FIO on such matters because foreign regulatory agencies may view the U.S. Treasury as their counterpart organization and FIO has the expertise to engage specifically on international insurance matters. FIO has worked with foreign regulators to encourage those foreign governments to implement less-restrictive and more sound prudential and regulatory measures, which allow U.S. insurers to trade more freely in those markets. The most prominent example of such intervention is the U.S-EU Covered Agreement, though less-formal engagements with governments such as those of Argentina and Brazil also have yielded important results for U.S.

insurers' competitiveness abroad. Following on these successes, AIA continues to support increased transparency in international insurance negotiations and continued Congressional oversight. But we do caution against adding more layers of federal involvement that could lead to unintended influence over the state-based insurance regulatory system.

Last, but not least, while the Dodd-Frank Act preserves the primacy of state-based insurance regulation both generally and specifically, there is still one area – consumer protection regulation – where federal officials periodically attempt to assert regulatory authority. When the Consumer Financial Protection Bureau (CFPB) was established under Title X of the Dodd-Frank Act, the language included a very broad "business of insurance" exemption from CFPB jurisdiction with limited exceptions. Periodically, the CFPB has attempted to leverage its existing authority to gain access to information regarding insurance or to expand enforcement jurisdiction indirectly or directly to the business of insurance. State insurance regulators have been effective in regulating consumer protection; therefore, AIA supports efforts to effect Congressional intent by keeping the CFPB from engaging on insurance policy matters.

We look forward to this hearing on the federal government's role in the insurance industry and hope to continue to work with the committee to develop policy that supports the state-based insurance regulatory system, allows U.S. insurers to compete globally, and provides U.S. policyholders with the most efficient and effective insurance markets.

Respectfully submitted,

Wes McClelland

Vice President, Federal Affairs
American Insurance Association

Coalition Organized for the Future of Insurance Regulation (COFIR)

Chairman Sean Duffy
Housing & Insurance Subcommittee
2129 Rayburn House Office Building
Washington, D.C. 20515

Ranking Member Emmanuel Cleaver
Housing & Insurance Subcommittee
4340 Thomas P. O'Neill Office Building
Washington, D.C. 20024

October 23, 2017

Dear Chairman Duffy and Ranking Member Cleaver;

As Executive Director of the Coalition Organized for the Future of Insurance Regulation (COFIR), I write to express COFIR's appreciation for holding your October 24, 2017 hearing entitled "The Federal Government's Role in the Insurance Industry."

COFIR represents a broad cross-section of the insurance industry, including property and casualty companies, life and health companies and independent insurance agents and brokers. Our goal is to preserve and advocate for the national system of state-based insurance regulation and to promote modernization and improvements to that system for the benefit of U.S. policyholders.

The state-based system of insurance regulation has its roots in the mid-19th century with the state of New Hampshire appointing the first insurance commissioner in 1851. Nearly a century later the U.S. Congress formalized the role of the states in insurance regulation with the passage of the McCarran-Ferguson Act in 1945. The primacy of state regulation of insurance was reaffirmed with the passage of the Gramm-Leach-Bliley Act in 1999 and once again with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010.

As the Subcommittee on Housing and Insurance examines the U.S. insurance regulatory framework in this Congress and beyond, COFIR would like to emphasize how integral the state-based system of insurance regulation has been in protecting American consumers over the last 160 years. Even during the most recent financial crisis - as the federal banking and mortgage regulatory regimes collapsed - the state-based insurance regulatory system performed well, protecting policyholders and helping to prevent an even deeper economic downturn.

COFIR would also like to express its support for Chairman Duffy's and Representative Heck's efforts to strengthen our system of state-based insurance regulation in two pieces of legislation being considered by this Subcommittee -- H.R. 3762, the International Insurance Standards Act of 2017 and H.R. 3861, the Federal Insurance Office Reform Act of 2017. Both of these bills send a strong message that the U.S. system of insurance regulation has fostered a competitive marketplace with a diversity of insurance products that has served American consumers well for decades.

Specifically, H.R. 3762 would make certain that any international agreement on insurance regulation reflect the United States' successful framework of insurance regulation and that state insurance regulators are integrally involved in negotiations regarding global insurance standards. H.R. 3861, would focus the Federal Insurance Office's activities on international regulatory discussions in consultation with the states and more importantly reduce its domestic activities that are duplicative of state regulation.

We commend Chairman Duffy and Representative Heck for introducing these important bills and respectfully request that Congress pass them into law. Thank you for the opportunity to present our views on these important matters.

Sincerely,

Clifford Roberti
Executive Director
Coalition Organized for the Future of Insurance Regulation

CC:
Chairman Jeb Hensarling
Ranking Member Maxine Waters

STATEMENT BEFORE
THE UNITED STATES HOUSE OF REPRESENTATIVES
FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON HOUSING AND INSURANCE

HEARING ENTITLED
"THE FEDERAL GOVERNMENT'S ROLE IN THE INSURANCE INDUSTRY"

October 24, 2017

Founded in 1896, the Independent Insurance Agents & Brokers of America (IIABA or the Big "I") is the nation's oldest and largest national association of independent insurance agents and brokers, representing a nationwide network of approximately a quarter of a million agents, brokers, and their employees. Its members are businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents and brokers offer all lines of insurance—property, casualty, life, health, employee benefit plans, and retirement products.

The focus of today's hearing is the role of the federal government in the insurance industry. Congress passed the McCarran-Ferguson Act (15 U.S.C. §§ 1011 et seq.) in 1945 which outlined that states are the primary regulators of insurance markets except where a federal law expressly provides otherwise. The Big "I" strongly opposes any form of federal regulation of insurance, whether optional, mandatory or dual. For decades, the Big "I" has been a leading supporter of a modernized state-based system of insurance regulation. The association firmly believes that the attributes of this system dramatically outweigh any perceived shortcomings or inefficiencies. State regulation continues to offer considerable benefits especially in the vital areas of solvency regulation and consumer protection. As such, the Big "I" is pleased with the recent introduction of three pieces of legislation that support state insurance regulation.

First, H.R. 3861, the "Federal Insurance Office Reform Act of 2017," introduced by Reps. Sean Duffy and Denny Heck, aims to restrict the authority of the Federal Insurance Office (FIO). The FIO was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. §§ 5301 et seq.) in 2010 and is an information gathering body housed within the Department of Treasury. In addition to information gathering, FIO supports the U.S. Trade Representative in the negotiation of certain international insurance agreements and represents the federal government at the International Association of Insurance Supervisors (IAIS). FIO also assists in administering the Terrorism Risk Insurance Program and conducts studies and reports on the insurance market. However, the FIO has proven over the years to have questionable value for the insurance market and consumers. Consequently, the Big "I" supports significantly restricting or eliminating the FIO, and appreciates that H.R. 3861 would take steps to limit the office.

Second, H.R. 3762, the "International Insurance Standards Act of 2017," also introduced by Reps. Duffy and Heck, would require federal officials to oppose international standards and actions that are inconsistent with state insurance law. The Big "I" supports this legislation. With many important insurance issues now being discussed on a global level, it is vital that the U.S. has a united front, clear objectives and a consistent approach to participating in these discussions. This approach must encompass all aspects of the country's diverse and effective state-based system for regulating insurance. This includes clearly defining negotiating objectives and parameters for federal officials representing the U.S., and establishing a series of requirements to be met before the FIO or the Federal Reserve can agree to the adoption of international insurance standards. The Big "I" also supports ensuring that state insurance regulators are involved in any insurance policy discussions occurring at the international level.

Third, H.R. 3746, the "Business of Insurance Regulatory Reform Act of 2017," introduced by Reps. Duffy and Gwen Moore, seeks to clarify that the Consumer Financial Protection Bureau's (CFPB) regulatory authority does not extend to state insurance markets. Title X of the Dodd-Frank Act exempted the business of insurance from the purview of the CFPB and reiterated that the regulation of insurance had been delegated to the states. Yet, the CFPB has taken actions that involve products and services that fall within the exclusive regulatory authority of the states. The Big "I" believes that H.R. 3746 would help to underscore the broad scope of the business of insurance exemption and to place needed parameters around the CFPB's regulatory actions.

The Big "I" also urges the Committee and Congress to work with the Administration to ensure that the National Association of Registered Agents and Brokers (NARAB) is implemented pursuant to legislation passed by Congress and signed into law in 2015. Once implemented, NARAB would provide a one-stop licensing compliance mechanism for insurance agents and brokers operating outside their home states, while preserving the longstanding authority of states to oversee insurance producers. NARAB is prohibited from using federal funds and would function as a non-governmental, membership-based, nonprofit corporation. However, before NARAB can begin operation a Board of Directors must be appointed.

The President appoints Board members with the advice and consent of the Senate based on the expedited procedures outlined in Senate Resolution 116 of the 112th Congress. The previous administration ultimately nominated ten individuals; but, the Senate failed to act on the nominees. Therefore, these individuals must be re-nominated and/or new individuals must be appointed. It is important for this appointment process to occur quickly because no action or progress can occur until a Board is selected.

Finally, the Big "I" would like to provide comment on one additional bill related to insurance regulation: H.R. 3363, the "CLAIM Act," introduced by Reps. David Kustoff and Bill Foster. The CLAIM Act is intended to create more uniformity and reciprocity for independent adjuster licensing. It does not require states that do not license adjusters to do so, however if a state does license adjusters and does not meet certain standards of uniformity and reciprocity then the legislation calls for adjusters to utilize NARAB to obtain a license to operate in multiple states. The Big "I" supports uniformity and reciprocity for state insurance licensing laws where practical, but is concerned that under H.R. 3363 NARAB could potentially be used to arbitrate verdicts regarding preemption of state law, instead of its intended function as a licensing clearing house. As such, the Big "I" hopes to continue to work with the bill sponsors, the Committee and Congress to ensure that any federal legislation intending to utilize NARAB does so in a manner that is consistent with the purpose of NARAB and that does not inappropriately preempt state licensing laws related to insurance.

In conclusion, the Big "I" appreciates the recent introduction of H.R. 3861, H.R. 3762, and H.R. 3746. All three bills support state insurance regulation. The Big "I" also urges the Committee and Congress to work with the Administration to move forward on the appointment process for the NARAB Board of Directors; and to continue to work with stakeholders to make sure that any federal legislation impacting NARAB does not detract from the important purpose of NARAB. The Big "I" thanks the Committee for the opportunity to express the views of independent insurance agents and brokers and thanks the Committee for holding this important hearing.

House Committee on Financial Services

Subcommittee on Housing and Insurance

Hearing on "The Federal Government's Role in the Insurance Industry"

Testimony of Catherine Weatherford

President and CEO, Insured Retirement Institute

October 24, 2017

Insured Retirement Institute

Chairman Duffy, Ranking Member Cleaver, and Members of the Subcommittee, my name is Cathy Weatherford and I am the President and CEO of the Insured Retirement Institute. I am pleased to provide our perspective on federal government's role in the insurance industry. I commend you for holding this hearing, and I welcome the opportunity to provide testimony to the Subcommittee.

Summary of Testimony

Consistent with our consumer–focused mission, my testimony today will address two (2) key points:

1. The Federal Insurance Office (FIO) should use its expertise and industry knowledge in collaboration with state insurance commissioners to educate federal regulators on the importance of enacting common-sense retirement security policies, such as those laid out in IRI's 2017 Retirement Security Blueprint. These policies include amending DOL's annuity selection safe harbor for employers, establishing annuity portability for workers in workplace retirement plans, and lifetime income estimation disclosures for the benefit for all workers.
2. Appointments should be made to the National Association of Registered Agents and Brokers Board (NARAB) as soon as possible. The establishment of a national clearinghouse for insurance licensing will maintain important consumer protections, retain states' authority to regulate the marketplace, and ultimately remove a barrier that is impeding broker-dealers' ability and financial advisors' willingness to sell lifetime income products. However, the board cannot begin functioning until its members are appointed.

About IRI

As you may know, I have over 30 years of regulatory experience, including over half of that time as an elected Insurance Commissioner and Insurance Department staff in the State of Oklahoma. Prior to joining IRI, I served as CEO of the National Association of Insurance Commissioners for 12 years, where I worked with over 50 state insurance commissioners to craft important consumer protections, including critical measures aimed at safeguarding our senior citizens. I joined IRI because my life's work is perfectly aligned with IRI's mission.

IRI exists to vigorously promote consumer confidence in the value and viability of insured retirement strategies, bringing together the interests of the industry, financial advisors and consumers under one umbrella. Our mission is to: encourage industry adherence to highest ethical principles; promote better understanding of the insured retirement value proposition; develop and promote best practice standards to improve value delivery; and to advocate before public policymakers on critical issues affecting insured retirement strategies and the consumers that rely on their guarantees.

IRI is the only national trade association that represents the entire supply chain for the insured retirement strategies industry. We have over 200-member companies, including major life insurance companies, banks, broker-dealers, and asset management companies. Our member companies represent more than 97 percent of annuity assets, and include the top 15 distributors ranked by assets under management. We offer education, research and advocacy resources to more than 180,000 financial advisors and more than 6,000 home office professionals affiliated with our member companies.

Our members are represented by hundreds of thousands of registered financial advisors across the country, and therefore, we bring a perspective from Main Street America to the Congress today. After my many conversations with these financial advisors, I have developed a deep level of appreciation for the long—standing relationships they have with their clients and friends—ten, twenty or even forty years. Our financial advisors consider that relationship to be a sacred trust and as such, they are intensely committed to helping their clients reach their retirement income objectives, which involves a series of the most significant financial decisions a person ever makes over a very long lifetime.

America's Retirement Income Crisis and the Roles of Insured Retirement Products & Professional Financial Advice

Americans today are at risk of outliving their assets. The longevity risk has never been greater. The shift from defined benefit to defined contribution plans, longer life spans, and the rising costs of health care are among the challenges that will put a significant retirement savings and income burden on the shoulders of individual consumers, in particular middle-income Americans. This reality underscores the critical importance of a regulatory environment that provides consumers access to products that meet their need to protect against longevity risk. Insurance companies and their distribution partners are the only providers of guaranteed lifetime income products.

Background

The Dodd-Frank legislation established the Federal Insurance Office (FIO) within the Treasury Department. The FIO is charged with monitoring all aspects of the insurance industry.

The Dodd-Frank law mandated that the FIO "conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation" by January of 2012. The FIO was mandated to "coordinate with each relevant Federal agency and state insurance regulator...and any publically available sources to determine if the information to be collected is available from, and may be obtained in a timely manner by, such Federal agency or state insurance regulator...or publically available source," according to Section 313 of the Dodd-Frank law.

Congress enacted the National Association of Registered Agents and Brokers Reform Act (NARAB II) in January 2015 to create a national insurance licensing clearinghouse for financial professionals operating in multiple states. By making the licensing process more streamlined and compliance with licensing regulations less onerous, NARAB will encourage broker-dealers and advisors operating in multiple states to offer insurance products such as annuities with lifetime income guarantees.

Role of the Federal Insurance Office

As the only federal office with extensive knowledge and understanding of the insured retirement industry, the FIO in collaboration with state insurance commissioners is uniquely positioned to advocate for and assist federal agencies and the Congress to develop policies to improve the current state of retirement savings readiness in America. IRI believes the FIO should focus on sharing its expertise with other federal agencies to assist them in developing a regulatory environment that will facilitate and encourage broader access to and use of retirement savings opportunities and guaranteed lifetime income solutions. IRI's 2017 Retirement Security Blueprint recommends a number of policy changes to achieve this goal, including the three examples below. IRI shared its recommendations on these issues with the FIO in a letter sent in 2011. A copy of the letter may be accessed here.

Amending the DOL Annuity Selection Safe Harbor for Employers

Current DOL rules provide a safe harbor that employers can follow to satisfy their fiduciary responsibilities regarding the selection and monitoring of annuity providers. Unfortunately, plan sponsors have not generally taken advantage of this safe harbor, due primarily to the fact that the safe harbor requires them to determine whether the annuity provider will be able to satisfy all their obligations under the contract.

During the last Congress, the Senate Finance Committee, on a unanimous bi-partisan basis, approved *S.3471, the Retirement Enhancement and Savings Act (RESA)*, sponsored by Chairman Hatch and Ranking Member Wyden, which contained revisions to the safe harbor that would enable retirement plan sponsors to satisfy their fiduciary obligations by obtaining a certification from the provider that it meets certain state insurance regulatory standards (e.g., licensed in 26+ states; not operating under an order of supervision, rehabilitation or liquidation), and has been working with DOL to advance this proposal.

The FIO should provide assistance to the DOL in amending its annuity selection safe harbor rule, to adopt these requirements.

Enable Annuity Portability for Workers

In addition to expanding coverage for American workers, retirement programs need to ensure that workers in an increasingly mobile economy can carry their benefits with them across an entire career. Congress should amend a technicality in the tax code to make a record keeping change a distributable event for annuities with lifetime income benefits. This change will ensure that workers do not lose the lifetime income guarantees they have already paid for if their employer decides to change annuity products or service providers.

Unfortunately, to avoid this possibility, many employers simply choose not to offer lifetime income options to their workers. Necessary changes to the tax code regarding lifetime income portability were included in *S. 3471, the Retirement Enhancement and Savings Act of 2016,* during the 114th Session of Congress and would help to solve this problem.

The FIO should support and advocate for the passage of this legislation.

Lifetime Income Disclosure on Benefit Statements for Workers

To help workers save appropriately for retirement, they need to be aware of how much monthly income their nest egg will generate in retirement. In 2013, DOL published an Advance Notice of Proposed Rulemaking that describes a draft rule that would require benefit statements to provide estimated lifetime income payments based on a plan participant's accrued benefits and projected future accrued benefits. IRI launched and completed a research project designed to provide DOL with additional guidance as to how the illustrations rule should be constructed.

The Lifetime Income Disclosure Act (H.R. 2055/S. 868) was reintroduced by Representatives Luke Messer and Mark Pocan in the House of Representatives and by Senators Johnny Isakson and Chris Murphy in the Senate. It was also included in S. 3471, *the Retirement Enhancement and Savings Act of 2016,* sponsored by Chairman Hatch and Ranking Member Wyden which was introduced and unanimously approved by the Senate Finance Committee during the 114th Session of Congress. The bill would ensure that employers provide 401(k) participants with a projection of their monthly income at retirement, based on the current balance of the account. Research by IRI found that more than 90 percent of workers want these estimates and find them helpful, while a full 75 percent of workers said they would increase their savings level by a few percentage points or more after seeing these retirement income estimates.

The FIO should assist DOL with the development of rules requiring lifetime income disclosure and advocate for the passage of the *Retirement Enhancement and Savings Act.*

Complete implementation of NARAB II Legislation for Insurance Agents

The National Association of Registered Agents and Brokers Reform Act (NARAB II) established a one-stop, federal licensing clearinghouse for financial professionals holding state insurance licenses in multiple states. Financial professionals who have passed background checks in their home state will be able to apply for NARAB membership to sell guaranteed lifetime income products in other states without the burden of dealing with multiple state insurance departments.

This common-sense policy maintains important consumer protections, retain states' authority to regulate the marketplace, and ultimately removes barriers that impede broker-dealers' ability and financial advisors' willingness to sell lifetime income products.

Before NARAB can commence operations, the President must nominate, and Senate confirm a 13-member Board, comprised of eight current state insurance commissioners, three representatives of the property/casualty industry and two representatives from the life and health sectors. Although many nominations were made during the previous administration, they failed to be considered by the Senate in time before the nominations expired. IRI respectfully requests the members of this committee urge both the President to move expeditiously to nominate members of the board and your colleagues in the Senate to speedily confirm those nominees.

The nomination and confirmation of the NARAB board members will enable the FIO complete implementation of the law and establish NARAB as the one-stop federal licensing clearinghouse for financial professionals holding state insurance licenses in multiple states. Financial professionals who have passed background checks in their home state will be able to apply for NARAB membership, enabling them to sell guaranteed lifetime income products in other states and reduce the regulatory burden of dealing with multiple state insurance licensing processes, while ensuring clients have access to a full suite of lifetime income options. The law maintains important consumer protections, retains states' authority to regulate the marketplace, and improves consumer choice.

Conclusion

Thank you again for the opportunity to present this testimony. We hope you will find it useful, and we would welcome the opportunity to work with the Subcommittee in the future as you consider additional legislative and regulatory changes to help all Americans achieve real retirement security.

NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

Local Agents Serving Main Street America℠

STATEMENT BEFORE THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND INSURANCE HEARING ON THE FEDERAL GOVERNMENT'S ROLE IN THE INSURANCE INDUSTRY
October 24, 2017

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*℠.

Introduction

PIA appreciates the subcommittee holding this hearing and thanks Chairman Sean Duffy for his leadership on insurance issues. PIA also appreciates the subcommittee providing this opportunity to address some of the threats to state insurance regulation.

PIA does not believe the federal regulatory system should have a role in the insurance industry, given the success of our state system of insurance regulation that has protected consumers and created a competitive and diverse U.S. insurance market for over 150 years. The creation of certain offices in the past has threatened state regulation, and we have seen recent attempts by these offices to increase their power.

Insurance is fortunate to have in place a local supervisory system that allows the states, rather than a federal bureaucracy, to ensure fairness for policyholders. This system has prevented major financial disasters; a report issued by the Government Accountability Office (GAO) in June 2013 found the state-based system of insurance regulation helped to mitigate the negative effects the 2008 financial crisis might otherwise have had on the insurance industry. A federal office dealing with insurance regulation is an unnecessary potential threat to state insurance regulation.

PIA opposes any federal or international effort that would undermine the state-based system of insurance regulation, like creating federal offices that intrude on the work of state insurance regulators or adopting a one-size-fits-all approach to global insurance regulation. Instead of broad national and global requirements, PIA supports coordination and cooperation among state regulators, federal officials, and international bodies. Such cooperation can help improve the existing insurance regulatory system.

Federal Insurance Office

In 2010, advocates of federal insurance regulation succeeded in getting the Federal Insurance Office (FIO) established as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). PIA National opposed the creation of the FIO from the outset. Leaving aside ideology, there has never been a need to create an office like the FIO. PIA's opposition to FIO's creation was somewhat tempered by the fact that the FIO's enabling legislation did not provide it with broad authority to regulate or supervise insurance, and its director was not a political appointee, a condition that would have unnecessarily elevated its profile.

Many of the duties of the FIO are examples of federal overreach in the context of our current system of state insurance regulation. Like most Federal offices, once created, it sought to consolidate its power. This happened even though the FIO should not have been formed in the first place. Over the last seven-plus years of its existence, the FIO has called for federal regulation of mortgage insurance; for its inclusion in supervisory colleges with state regulators; and for uniform national standards for state guaranty associations. It also issued a report on consumer protections that was far beyond the scope of its authority. Every one of these acts was an overreach, all well outside its mandate.

The FIO also rejected the expertise of the insurance industry by concurring with Systemically Important Financial Institutions (SIFI) designations (which have since been questioned) for nonbank insurance institutions under Dodd-Frank. Additionally, the FIO took part in creating a harmful deal with the European Union on an international covered agreement that could open the door for Europe to impose its standards on U.S. insurance companies.

The role of the FIO in the creation and implementation of the National Association of Registered Agents and Brokers (NARAB) is grossly misunderstood; that misunderstanding is instructive as to how the FIO's existence threatens the state insurance regulatory system. Created in January 2015, the purpose of NARAB is to provide a mechanism through which non-resident producer licensing requirements may be adopted and applied on a multi-state basis. Somehow, over the years, the FIO has gradually assumed responsibility for the identification of NARAB board members and administration of the program once it is up and running. This is an explicit abuse of FIO's mandate; NARAB's enabling legislation does not mention FIO in any way. FIO has no right to administer NARAB, but FIO's claim of authority is a classic example of a federal office in continuous search for greater power, even if that search demands that they exceed the confines of their mandate.

In November 2016, PIA became the first association to publicly call for the repeal of the FIO. Over the last year, we have been joined by other stakeholders seeking to dismantle this office.

This spring, PIA expressed strong concerns about a FIO-related provision included in the Financial Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs (CHOICE) Act. The CHOICE Act would have folded the FIO into a newly-created, even more powerful insurance office called the Office of the Independent Insurance Advocate, which would have been granted vast new authority with virtually no accountability. PIA submitted testimony this spring warning of the unintended consequences of creating the Independent Insurance Advocate's office, and we encourage Congress to reject any effort to include it in future legislation.

PIA has since worked with members of Congress to develop legislation that would reign in and scale back the power of the FIO. As such, PIA supports H.R. 3861, the Federal Insurance Office Reform Act of 2017 (FIO Reform). While PIA National has advocated for and continues to seek the full repeal of this office, we support this legislation, as it will begin to scale back the FIO's authority, particularly on some domestic matters.

Importantly, the bill moves the FIO from an independent realm of the Treasury Department into the Department's Office of International Affairs; this will properly subordinate the office to the Treasury. The office will also be limited to five staff members. Since its creation, FIO has unilaterally sought to gradually expand its authority beyond the mandate of Congress, so these changes are important steps.

The FIO Reform Act also removes FIO's improper assumption of certain duties, like its advisory role to the Financial Stability Oversight Council. Under this bill, FIO will no longer have subpoena power, and its power to issue reports will be somewhat curtailed. FIO will continue to have a role in negotiating international covered agreements, but the bill requires state insurance commissioners to be consulted and involved throughout such negotiations. Consistent state regulatory involvement will provide an important check on FIO's power.

PIA views this legislation as an important stepping stone toward the FIO's disentanglement in the process of designating systemically important financial institutions. In keeping with its move to the International Affairs Office, FIO should not retain authority to monitor either gaps in U.S. insurance regulation or the accessibility and affordability of insurance. Such duties give the FIO the opportunity to expand the scope of its power in the future.

PIA supports efforts to reign in the FIO, but, in the long run, we will continue to seek the office's repeal. PIA agrees with the notion that a unified U.S. voice in international negotiations is good for U.S. policyholders and the domestic insurance market. The U.S. Trade Representative office can negotiate international agreements, and it, combined with the existing robust state insurance regulatory framework, render the FIO as it exists right now unnecessary.

International Agreements

International negotiations can have serious consequences for the domestic insurance industry. While states are the primary regulators of insurance in the United States, developments at the international level can heavily influence laws and regulations at the state level. If global standards are promulgated without appropriate consideration of the unique state-based system of U.S. insurance regulation, they may increase systemic risks and consumer costs by pushing small and midsize companies out of business and reducing competition.

PIA National firmly believes that negotiations and agreements into which the U.S. government enters establishing international insurance standards should be consistent with our state-based system of insurance regulation, be handled in a transparent manner, and include the opportunity for Congress to intervene to stop their implementation.

A recent example of the impact international negotiations can have on the U.S. insurance industry was when the FIO made a bad deal in reaching the recent covered agreement with the European Union. PIA believes this agreement constituted a solution in search of a problem: whether the U.S. system is equivalent to Europe. It opens the door to allowing Europe to impose its regulatory standards on U.S.-regulated insurance markets. PIA believes that this agreement highlights what we have been saying for some time: state insurance regulators must have a role in negotiating international covered agreements that affect the American insurance industry, and Congress must be able to prevent an agreement from going into effect. Further, U.S. representatives engaged in negotiations should understand that their role is not to undermine the successful U.S. insurance industry during that process.

To this end, PIA supports H.R. 3762, the International Insurance Standards Act of 2017, which would require consultation with Congress, involve state insurance commissioners in the negotiation process, and include a mechanism for Congress to prevent an agreement from being enforced. H.R. 3762 would also prevent negotiators from agreeing to any provisions that are inconsistent with or do not recognize any federal or state regulations, laws, or policies that govern the regulation of insurance in the United States. This legislation will finally offer protection for the U.S. insurance industry as these negotiations take place.

Conclusion

PIA believes that the proper place for the regulation of insurance is at the state level, which has served the insurance industry and consumers well for over one hundred years. Any attempt to move toward the federal regulation of insurance is inappropriate and would negatively affect policyholders.

The power of the FIO should be significantly curtailed, and eventually, the office should be repealed. In addition, as federal entities negotiate on behalf of the United States at the international level, it is essential that insurance regulators be part of the negotiation process and that Congress have the ability to prevent a harmful agreement from being put into effect. 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.

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STATEMENT FOR THE RECORD

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND INSURANCE

HEARING ON

THE FEDERAL GOVERNMENT'S ROLE IN THE INSURANCE INDUSTRY

OCTOBER 24, 2017

The Reinsurance Association of America (RAA) appreciates Chairman Duffy, Ranking Member Cleaver, and Committee on Financial Services members' support of the U.S. property casualty (re)insurance industry. Thank you for holding today's hearing to examine "The Federal Government's Role in the Insurance Industry."

The RAA is a national trade association representing property casualty reinsurance companies doing business in the United States. RAA membership includes reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross-border basis. The RAA also has life reinsurance company affiliates.

Reinsurance is a global business. Encouraging and facilitating the participation of reinsurers around the globe is essential to providing needed capacity in the U.S., the world's largest property and casualty market. Reinsurance plays a critical role in assisting in recovery after natural catastrophes. The benefit is notable for 2017. Recent public estimates suggest that insured risks for recent catastrophes, including Hurricanes Harvey, Irma, Maria and Nate, and the Mexican earthquakes, could exceed $100 billion. It is projected that half of this may be paid by global reinsurers, infusing much needed capital into the U.S. from around the globe. One specific example, is the Federal Emergency Management Agency's first purchase of reinsurance on the National Flood Insurance Program in 2017, which will likely result in $1.042 billion in claims payments by over two dozen reinsurers for the recent losses. Reducing barriers and facilitating risk transfer into the global market encourages competition in the reinsurance sector and enhances the resiliency of the U.S. economy.

FEDERAL ROLE

The RAA supports the primacy of the U.S. state-based insurance regulatory system, which was affirmed by the Dodd-Frank Wall Street and Consumer Protection Act of 2010 and the recently signed U.S.-EU Covered Agreement. International issues provide challenging constitutional issues for states and sometimes require federal involvement to address them, including the authority to enter into international agreements.

The RAA supports preserving the Federal Insurance Office and several of its functions, including FIO's authority to represent Treasury internationally and, Treasury's authority with the U.S. Trade Representative, to enter into a covered agreement.

FEDERAL-STATE COLLABORATION

The RAA supports the continued collaboration and participation of Federal and state insurance officials in international insurance fora, including the International Association of Insurance Supervisors (IAIS). It is critical that U.S. Federal representatives coordinate with state insurance regulators to more effectively advocate, among other issues, for U.S. (re)insurers to be competitive throughout the world.

U.S. COMPETITIVENESS

U.S. (re)insurers' competitiveness abroad has been under siege for many years. The recently-signed U.S.-EU covered agreement ("Agreement") demonstrates a productive way to resolve such conflicts. The RAA commends the Administration for executing the Agreement and appreciates the accompanying clarifying statement regarding implementation (See attached Treasury-USTR press release and "Statement of the United States on the Covered Agreement with the European Union"). This significant milestone utilizes federal tools to recognize the strength of the U.S. state-based regulatory system and formalize the strong regulatory cooperation between the U.S. and the European Union on insurance and reinsurance issues for the benefit of companies doing business in both jurisdictions. This establishes a model of regulatory cooperation between well-regulated jurisdictions for others to follow.

TRANSPARENCY

RAA supports the goal of increased transparency in the global international insurance standard setting process, to include stakeholder access and input. We would caution that any new processes and procedures not be constructed in a manner that inhibits the U.S. participants' ability to participate in a timely manner.

CONCLUSION

The RAA supports striking a balance between strengthening U.S. (re)insurer competitiveness, representation, and transparency abroad while promoting international recognition for the U.S. insurance regulatory system, including state-based insurance regulation, enhancing Congressional oversight, and increasing stakeholder input and collaboration here in the U.S.

U.S. DEPARTMENT OF THE TREASURY

Press Center

Treasury, USTR Sign Covered Agreement on Prudential Insurance and Reinsurance Measures with the European Union

9/22/2017

WASHINGTON – The U.S. Department of the Treasury (Treasury) and the Office of the U.S. Trade Representative (USTR) today signed a covered agreement (the Agreement) on prudential insurance and reinsurance measures with the European Union (EU). Treasury and USTR also jointly issued a policy statement clarifying how the United States views implementation of certain provisions of the Agreement.

The Agreement addresses three areas of prudential insurance supervision: group supervision, reinsurance, and exchange of information between supervisory authorities. The Agreement affirms the U.S. system of insurance regulation, including the role of state insurance regulators as the primary supervisors of the business of insurance in the United States.

"After extensive stakeholder engagement and review, Treasury has concluded that the covered agreement with the EU is a win for the United States, its insurance industry, and U.S. policyholders," said Treasury Secretary Steven T. Mnuchin. "By providing regulatory clarity and reducing regulatory burden, the Agreement enables American companies to be more competitive in the EU, enhances opportunities for U.S. insurers and reinsurers at home and abroad, and furthers the administration's goal of sustained economic growth."

U.S. Trade Representative Robert Lighthizer said, "The Agreement with the EU levels the playing field for the U.S. insurance industry, thereby strengthening American competitiveness in the EU. The Agreement, which will be implemented consistent with the U.S. policy statement, promotes U.S. interests by protecting consumers here at home and relieving U.S. insurers of compliance with potentially redundant EU regulatory requirements."

The United States is committed to promoting the interests of U.S. insurers, U.S. reinsurers, U.S. insurance regulators, U.S. consumers, and the U.S. economy as the Agreement is implemented. The United States will continue its engagement with stakeholders and state regulators as implementation of the Agreement moves forward.

The final legal text of the U.S. - EU covered agreement is available here and the text of the U.S. policy statement is available here .

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AMERICAN BANKER.

AIG's Collapse: The Part Nobody Likes to Talk About

Hester Peirce - JUN 16, 2014 12:00pm ET

Earlier this month, American International Group announced the departure of Robert Benmosche, the CEO who led the company through most of its recovery from the financial crisis. Now that the company's postcrisis chapter is underway, it is worth taking a fresh look at AIG's downfall and rescue and the implications for reform.

The standard AIG story lays all the blame for the company's problems on AIG Financial Products—an allegedly unregulated, irresponsible, derivatives dealer hiding within an otherwise solid insurance company.

Former Treasury Secretary Timothy Geithner repeats this traditional line in his recent book, where he recounts how an aggressive "hedge fund-like subsidiary called AIG Financial Products" brought the otherwise healthy insurance company to its knees and ultimately drove it into the Fed's welcoming arms. Former Federal Reserve chairman Ben Bernanke made a similar claim when he told Congress how angry he was about AIG's Financial Products unit—"a hedge fund attached [to] a large and stable insurance company." And former Commodity Futures Trading Commission Chairman Gary Gensler, with typical dramatic flair, explainedthat AIG's "subsidiary, AIG Financial Products, operating out of London, brought down the company and nearly toppled the U.S. economy."

This widely repeated narrative ignores or downplays a critical aspect of AIG's downfall—the insurer's securities lending program run for the benefit of its regulated life insurance subsidiaries.

An endnote in Geithner's tome explains that securities lending was one of "AIG's major liquidity needs" at the time of its rescue. As I describe in a recent working paper, the company got itself into hot water by lending securities from its life insurance companies' portfolios. AIG took the cash collateral it received for these short-term loans and—in a departure from insurance industry practice—invested much of it in longer term, illiquid residential mortgage-backed securities.

The securities lending program grew from about $10 billion at the end of 2001 to over $80 billion by the end of 2007. When borrowers stopped renewing the loans, returned their securities, and asking for their cash back, AIG was in a bind—the borrowers' cash was tied up in reinvestments.

To meet borrowers' demands, AIG lent more securities and used the cash collateral from new borrowers to return to existing borrowers. This solution only aggravated the problem. When CEO Robert Willumstad took the reins of AIG in June 2008, the cash drain from securities lending worried him more than AIG Financial Products' liquidity needs.

Losses from the securities lending program threatened the viability of a number of AIG's regulated life insurance subsidiaries. To save them from falling below minimum capital requirements, AIG pumped billions of dollars into these units.

Government rescue money was critical to this recapitalization effort. Taxpayer funds were also critical in meeting securities borrowers' demands for cash. Securities lending counterparties received $43.8 billion in the last quarter of 2008, comparable to $49.6 billion in collateral postings and payments to AIG's derivatives counterparties.

As consequential as it was to AIG in a time of crisis, nobody likes to tell the securities lending part of the story. First, it doesn't feed as nicely into the vilification of derivatives that laced crisis narratives and fueled calls for an intense derivatives regulatory regime. Second, the fact that heavily regulated insurance companies got into trouble does not support the call for greater reliance on government regulators. Finally, the rescue of a deeply troubled company is less defensible than the rescue of a healthy insurance company with a troubled derivatives subsidiary.

The Fed's contention that its loan was adequately secured rested on the supposition that apart from the derivatives unit, AIG was sound. The banks that went in to AIG in September 2008 to assess whether it was worth rescuing concluded that it was not.

As one of the private bankers subsequently explained, "The value of the company in its entirety was not necessarily sufficient to cover the liquidity need that the company had."

Geithner recounts in his book that—looking for confirmation that a loan to AIG would comply with the legal requirement that "the Fed can only lend against reasonably solid collateral"—he asked Warren Buffett "what he thought about the earning power of AIG's traditional insurance subsidiaries." Buffett "was pretty positive about their underlying value, which made [Geithner] more confident that [the Fed] could meet the legal test of being secured to [its] satisfaction." Buffett's words of assurance to Geithner weren't matched by a willingness to put his own money on the line; he refused AIG's overtures to invest during 2008.

AIG was on the verge of filing for bankruptcy when the Fed stepped in with a better deal for shareholders and creditors. The government subsequently re-rescued the company by devoting additional taxpayer funds to it and softening the lending terms. At any of these re-rescue points, the government could instead have let the company go through bankruptcy.

By continuing to prop up AIG, the government shielded the company from the toughest regulator of all—the markets. AIG's problems were not confined to one unregulated corner; problems also arose in full view of insurance regulators. Rather than assuming the Fed will be better than AIG's other regulators, we ought to allow the truly superior regulator—the market—to do its job.

Hester Peirce is a senior research fellow with the Mercatus Center at George Mason University and author of the Mercatus Center working paper, "Securities Lending and the Untold Story in the Collapse of AIG."

QUESTIONS FOR THE RECORD
CONGRESSWOMAN JOYCE BEATTY (OH-03)
FINANCIAL SERVICES COMMITTEE HEARING, HOUSING AND INSURANCE SUBCOMMITTEE, OCTOBER 24, 2017
"THE FEDERAL GOVERNMENT'S ROLE IN THE INSURANCE INDUSTRY"

Question #1

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Reserve has the supervisory authority over Insurance Savings and Loan Holding Companies (ISLHCs) at the holding company level. However, I believe, although well-intentioned, this federal day-to-day supervision has proved to be out of line with the risk posed to the stability of the United States financial system by these ISLHCs.

There are only a dozen or so of these ISLHCs that fall within the Federal Reserve's jurisdiction. These are not the largest insurance companies in the U.S. nor are they the riskiest insurance companies in the U.S. Yet, they are subject to additional federal supervision because they are structured as ISLHCs. One of these companies is Nationwide Insurance, which is headquartered in my district and employs thousands of my constituents.

Is the state regulatory system incapable of conducting the proper day-to-day supervision of these insurance companies, hence the need for Federal Reserve supervision?

Absolutely not. Our system of state regulation has for more than a century served consumer and insurer needs well. The state-based insurance regulatory system has proven to be adaptable, accessible, and effective, with rare insolvencies and no taxpayer bailouts, with each state also able to tailor law and regulation to the unique needs of its consumers. I do not see a need for the Federal Reserve Board to be involved in the day-to-day supervision of any insurance company, regardless of its affiliation with a banking entity.

It is very important to ensure that the Federal Reserve Board's oversight complement, rather than supplant, state insurance regulation. To that end, I also believe that Congress should pass legislation making clear that the examination and oversight of the individual insurance companies within insurance groups being supervised by the Federal Reserve Board would be conducted by state insurance regulators. This clarity would help to reduce regulatory inefficiency, duplication of effort, and unnecessarily high compliance costs.

QUESTIONS FOR THE RECORD
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Is the state regulatory system incapable of conducting the proper day-to-day supervision of these insurance companies, hence the need for Federal Reserve supervision?

Answer

The state insurance regulatory system is quite capable of conducting the proper day-to-day supervision of insurance savings and loan holding companies. For over 150 years it has a track record of comprehensive consumer protection for insurance policyholders. The insurance sector has been stable throughout the last several financial crises despite a confluence in the last decade of record storms, market contractions, and regulatory changes. The industry has achieved record levels of capitalization and residual markets for consumers and businesses are at or near historic lows. The states are continuously working to improve the insurance regulatory system, including since the 2008 financial crisis a renewed focus on enterprise risk management through both Enterprise Risk Reports and ORSA (Own Risk and Solvency Assessment) requirements. The Federal Reserve's primary focus should be the safety and soundness of the insured depository institution in an ISLHC, which can be assured without interfering with the state regulators that are supervising the insurance activities of the group. As long as the group has adequate regulatory capital under either the state or Federal Reserve's group capital systems, the Federal Reserve should rely on the states to supervise and examine the insurance group, without imposing additional excessive and unnecessary burdens and supervision.

Daniel Schwarcz's Responses to Questions Stemming from the House Committee on Financial Services Subcommittee on Housing and Insurance hearing entitled, "The Federal Government's Role in the Insurance Industry"

Questions for the Record from Congressman Hultgren (R-IL)

Question 1 –

Response
"Consensus" is defined by Webster's Dictionary both as "unanimity" and as "the judgment arrived at by most of those concerned." I am not aware of any formal definition of the term in NAIC materials or in any of the proposed bills that I have reviewed. As stated in my written testimony, "[T]he Federal Insurance Office Reform Act of 2017, H.R. 3861, would require that FIO develop a "consensus" among state insurance regulators with respect to all international positions. This proposal would effectively give a single state veto power on international insurance matters. In fact, states themselves rarely reach consensus with respect to policy and regulatory matters. As such, the provision could effectively limit the U.S. from taking any position on key issues in the international insurance arena. This, of course, would undermine U.S. influence and the capacity of state or federal actors to advance the U.S. insurance agenda internationally."

Question 2 –

Response
HR 3762 requires federal actors representing the US in international standard setting bodies to affirmatively oppose any agreements that would be "inconsistent with and [would] not reflect existing Federal and State laws, regulations, and policies on regulation of insurance, including the primacy of policyholder protection in solvency regulation." It also requires them to affirmatively op;;ose any agreements that "would not recognize existing Federal and State laws, regulations, and policies on the regulation of insurance as satisfying such proposals." The Act does not clearly define what types of agreements would run afoul of these broad standards, and thus creates the prospect of substantial uncertainty regarding the role of federal actors in future international negotiating regarding insurance standards. Once again quoting from my written testimony to the committee: "[T[here are indeed good reasons to believe that systemic risk issues in insurance are not sufficiently addressed by the current state-based system of insurance regulation. Handcuffing federal actors in their international dealings to absolute adherence to the current U.S. system of insurance regulation eliminates the possibility of making any progress in the future on this or related issues. It also effectively announces to the international community that the U.S. is completely unwilling to compromise with respect to any international insurance

issue. This approach will predictably lead the international community to simply cut out U.S. actors from the development of international insurance norms and standards."

Questions for the Record
Congresswoman Joyce Beatty (OH-03)
Financial Services Committee Hearing, Housing and Insurance Subcommittee, October 24, 2017
"The Federal Government's Role in the Insurance Industry"

Question #1

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Is the state regulatory system incapable of conducting the proper day-to-day supervision of these insurance companies, hence the need for Federal Reserve supervision?

Commissioner Wade on behalf of the NAIC:

U.S. state insurance regulators are fully capable of supervising insurance companies and have been Nationwide's primary regulators since its earliest inception in 1925. We currently oversee 100% of the U.S. private insurance market and engage in international leadership roles as group-wide supervisors, coordinating the oversight of large complex U.S.-based insurance groups. The U.S. insurance market is the largest and most competitive in the world and the state-based system's track record has been excellent for protecting policyholders and maintaining stable and competitive markets. To the extent the Federal Reserve is involved in the regulation of Savings and Loan Holding Companies engaged in insurance operations, the regulation should be limited primarily to that particular firm's banking activities to avoid unnecessary duplication of existing and long standing state authorities to regulate the business of insurance.

State insurance regulators recognize the need to periodically evaluate and improve our regulation. Since the financial crisis, state insurance regulators made several regulatory enhancements, particularly in the area of group supervision. State insurance regulators made significant changes to the NAIC's Model Holding Company Act.[1] These changes enhance state insurance regulators authorities over and provide regulators additional visibility into an insurance holding company including non-insurance affiliates. As part of this work, state insurance regulators also adopted the Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act[2] in 2012, which includes the ORSA Summary Report filing requirement. An ORSA filing

[1] *Insurance Holding Company System Regulatory Model Act* (NAIC Model #440).
[2] *Risk Management and Own Risk and Solvency Assessment Model Act* (NAIC Model #505).

provides an enterprise-wide, detailed description of the entity's risk management system, an identification of its key risks in normal and stressed environments, an assessment of its capital adequacy for the risks in normal and stressed environments, and identification of prospective risks.

State insurance regulators also updated the disclosure requirements of insurers' securities lending activity. These changes were driven in part by our experience with AIG's securities lending program during the financial crisis. While state insurance regulators were already in the process of addressing those concerns before the activities of the AIG financial products division necessitated the intervention of the federal government, insurance regulators believe that enhanced public disclosures of such activities will provide regulators additional insights into such activities and promote firm discipline relating to such activities.

State insurance regulators also support the need to assess the adequacy of an insurance group's capital position as part of coordinated solvency oversight and state insurance regulators are developing a group capital calculation to be used as a consistent regulatory analytical and assessment tool. We are in the process of coordinating our work on this initiative with the Federal Reserve as they develop capital requirements for those firms under their jurisdiction that are substantially engaged in insurance activities.

Finally, earlier this year, the NAIC launched the Macro Prudential Initiative (MPI) to improve the ability of state insurance regulators and industry to address macro-prudential impacts, focusing on four key areas: liquidity, recovery and resolution, capital stress testing, and exposure concentrations. The liquidity work is currently underway and includes addressing data gaps for regulators' existing work in assessing liquidity risk, as well as proposing a liquidity stress testing framework for larger life insurers.

House Committee on Financial Services Subcommittee on Housing and Insurance hearing entitled, "The Federal Government's Role in the Insurance Industry"

October 24, 2017

Questions for the Record from Congressman Hultgren (R-IL)

Ms. Katharine Wade, Commissioner, Connecticut Insurance Department, on behalf of the National Association of Insurance Commissioners

Question 1 –

The Federal Insurance Office Reform Act (HR 3861) requires FIO to achieve a "consensus" with the states before advocating or agreeing to positions in international forums.

a. How do you define "consensus"?
b. Has the NAIC adopted any guidance that defines "consensus" for the purpose of agreement between disparate state regulators?
c. Does "consensus" mean "unanimous" agreement" In other words, would one state be able to de facto veto achieving "consensus"?

Commissioner Wade on behalf of the NAIC:

Consensus means general agreement. It does not require unanimity nor does it require agreement by every single party on every single aspect of any given "consensus" position.[1] *Therefore, in this context, a disagreement of one state on a position or an aspect of it would not act as a defacto veto of a "consensus" veto.*

State insurance regulators have a long tradition of collaborating through the NAIC to achieve consensus positions on a variety of domestic and international issues. There is no specific NAIC guidance that defines the term consensus but the NAIC has both formal and informal procedures to ensure full state participation in decision-making to reach consensus positions. By way of just one recent example, once the proposed Covered Agreement text was published, the NAIC quickly convened meetings of all states to brief them on it, ascertain their views, and provide guidance to the NAIC regarding its response. Similar approaches can be utilized for other international matters.

[1] A general agreement. In *Oxford English Dictionary,* Retrieved December 1, 2017 from *http://www.oed.com/*
A generally accepted opinion; wide agreement. *Cambridge Dictionary Online*, Retrieved December 1, 2017, from https://dictionary.cambridge.org/us/
Majority of opinion. [Def. 1] or general agreement or concord; harmony. [Def. 2] *Dictionary.com*, Retrieved December 1, 2017 from http://www.dictionary.com/

Questions for the Record
Rep. Blaine Luetkemeyer (MO-03)
"The Federal Government's Role in the Insurance Industry"
Committee on Financial Services
Subcommittee on Housing and Insurance
October 24, 2017

To Commissioner Wade:

- The National Association of Insurance Commissioners and the States have taken several initiatives since the financial crisis to strengthen and improve state regulators' supervision of U.S. insurance companies and their subsidiaries. Could you discuss those efforts?

Commissioner Wade on behalf of the NAIC:

The 2008 financial crisis illustrated the need for financial regulators to ensure all risks are known and understood and that consumers are protected. With this in mind, state regulators, through the NAIC, made a number of changes to the insurance regulatory framework including those detailed below.

State insurance regulators made significant enhancements to the NAIC's Model Holding Company Act.[1] *These changes enhance state insurance regulators authorities over, and provide regulators additional visibility into, an insurance holding company including non-insurance affiliates. As part of this work, state insurance regulators also adopted the Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act*[2] *in 2012, which includes the ORSA Summary Report filing requirement. An ORSA filing provides an enterprise-wide, detailed description of the entity's risk management system, an identification of its key risks in normal and stressed environments, an assessment of its capital adequacy for the risks in normal and stressed environments, and identification of prospective risks. Leveraging these enhancements to our group supervisory authorities, state insurance regulators have led or participated in supervisory colleges (in-depth meetings of all key regulators for a particular firm across all its businesses and in all its markets) for all of the U.S. internationally active insurers.*

Further, in order to collect more detailed information on insurers' corporate governance practices, the NAIC adopted the Corporate Governance Annual Disclosure Model Act and Regulation. This action requires tailored, confidential reporting on an annual basis to ensure appropriate policies and procedures of insurers' internal oversight are in place and effective.

State insurance regulators updated disclosure requirements of insurers' securities lending activity. These changes were driven in part by our experience with AIG's securities lending program during the financial crisis. While state insurance regulators were already in the process

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[1] *Insurance Holding Company System Regulatory Model Act* (NAIC Model #440).
[2] *Risk Management and Own Risk and Solvency Assessment Model Act* (NAIC Model #505).

of addressing those concerns before the activities of the AIG financial products division necessitated the intervention of the federal government, insurance regulators believe that enhanced public disclosures of such activities will provide regulators additional insights into such activities and promote firm discipline relating to such activities.

Another long-standing project for the NAIC is the implementation of Principle-Based Reserving (PBR). PBR replaces a more formulaic method for determining life insurance policy reserves with an approach that more closely reflects the risks of highly complex products. The improved calculation is designed to "right-size" reserves, reducing reserves that are too high for some products and increasing reserves that are too low for others. This new method will help reduce the incentive for company workarounds of reserve requirements. Closely related to our shift to PBR are state regulators' efforts to promote consistency relating to the use of captive reinsurance by life insurance companies, which engage in such transactions to address redundancy in reserve requirements for certain products under the old formulaic method of reserving. While PBR should reduce the necessity for such transactions, the NAIC has adopted a comprehensive Reinsurance Framework such that a life insurer will be allowed to take financial credit for the reinsurance transaction with its captive only if certain financial criteria are met.

State insurance regulators also support the need to assess the adequacy of an insurance group's capital position as part of coordinated solvency oversight and state insurance regulators are developing a group capital calculation to be used as a consistent regulatory analytical and assessment tool. We are in the process of coordinating our work on this initiative with the Federal Reserve as they develop capital requirements for those firms under their jurisdiction that are substantially engaged in insurance activities.

Finally, earlier this year, the NAIC launched the Macro Prudential Initiative (MPI) to improve the ability of state insurance regulators and industry to address macro-prudential impacts, focusing on four key areas: liquidity, recovery and resolution, capital stress testing, and exposure concentrations. The liquidity work is currently underway and includes addressing data gaps for regulators' existing work in assessing liquidity risk, as well as proposing a liquidity stress testing framework for larger life insurers.

Congressman Brad Sherman
Questions for the Record
Financial Services Housing and Insurance Hearing "The Federal Government's Role in the Insurance Industry"
October 24, 2017

Questions for Katherine Wade, Commissioner, Connecticut Insurance Department:

1. How hard are you pushing to make sure that non-insurance companies that engage in credit default swaps are regulated as insurance companies?

   While I agree that certain credit default swaps have similar economic characteristics as insurance products, as you are probably aware, Title VII of Dodd-Frank sets forth the regulatory regime around swaps and provides regulatory authorities to the CFTC and the SEC over those markets. Prior to Title VII of the Dodd-Frank Act granting such authorities to the CFTC and SEC, federal and state regulators were preempted from regulating derivatives under the Commodity Futures Modernization Act of 2000. At this time, state insurance regulators including myself are not advocating for changes to Title VII of the Dodd-Frank Act.

   With that said, in addition to CFTC and SEC authorities, financial firms are also subject to the prudential requirements of their primary regulators. To the extent insurance companies engage in derivatives activities, they are subject to the solvency requirements of the state insurance regulatory regime, which place limitations on the extent of such activities, as well as any relevant CFTC or SEC authorities relating to the sale, purchase, or trade of such products. Similarly, Banks engaging in such activities are subject to prudential requirements of the banking regulators as well as relevant CFTC and SEC authorities over such products.
2. As you mentioned at the hearing, the Securities and Exchange Commission (SEC) regulates non-insurance institutions that engage in some credit default swaps. What are the capital requirements that the SEC places on institutions that engage in credit default swaps?

   As previously mentioned, the CFTC and the SEC have jurisdiction over the swaps market. I would have to defer to them regarding their specific regulatory requirements.

Responses from Ms. Katharine Wade, Commissioner, Connecticut Insurance Department, on behalf of the National Association of Insurance Commissioners in italics

Questions for the Record from Rep. Ed Royce (CA-39) for Commissioner Wade:

1. Is insurance interstate commerce?

Yes. The business of insurance is interstate commerce. See United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 64 S.Ct. 1162, 88 L.Ed. 1440 (1944)

2. What is your understanding of the States' role and relationship to Federal oversight in the U.S. insurance regulatory system?

The McCarran Ferguson Act provides that the "business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." The Act provides that no act of Congress shall invalidate any state law unless the federal law specifically relates to insurance. (15 U.S.C. § 6701). As it is an act passed by Congress that delegates the regulation of the business of insurance to the states, it is appropriate for Congress to conduct oversight of state insurance regulation as it does the implementation of other federal statutes.

3. You testified "on behalf of the National Association of Insurance Commissioners." What is your understanding of the NAIC's form and function and relationship to the States and to the Federal government?

The NAIC is an association of the chief insurance regulators of the 50 states, the District of Columbia, and the U.S. territories. The NAIC is a Delaware corporation, organized as a 501(c)(3) non-profit corporation, and is an instrumentality of the states.

4. Is the NAIC a private entity?

Yes. The NAIC is a private entity with its membership composed of state officials charged with regulating the business of insurance in their respective states.

5. May the NAIC regulate in interstate commerce?

No. The NAIC may not regulate interstate commerce.

6. Consider the following U.S. Supreme Court finding. "Significantly, when Senator McCarran presented to the Senate the bill agreed to in conference, he began by reading most of the foregoing quotation from the original House Report as part of his explanation of the bill [McCarran Ferguson Act]. ... The three Senate conferees, Senators McCarran, O'Mahoney, and Ferguson, repeatedly emphasized that the provision did not authorize state regulation of extraterritorial activities. ... Typical is the following statement by Senator O'Mahoney: '... Nothing in the proposed law would authorize a State to try to regulate for other States, or authorize any private group or association to regulate in the field of interstate commerce.' 91 Cong. Rec. 1483." Federal Trade Commission vs. Travelers, 1960. Does this precedent apply to

NAIC as a "private group or association"?

The NAIC is a private association with its membership composed of state officials and does not regulate in interstate commerce.

7. Does the NAIC regulate in interstate commerce?

No. The NAIC is not a regulator and does not regulate in interstate commerce.

8. Does Connecticut chair the ORSA Implementation (EX) Subgroup?

Yes. I currently chair the ORSA Implementation (E) Subgroup.

9. The NAIC has on staff an "ERM Advisor" whose "primary responsibility is to ... review ORSA reports and develop the actuarial scope of the ORSA reviews by the state regulators." Is NAIC regulating in the field of interstate commerce?

No. The role of the ERM advisor in question is to assist state insurance departments, at their request, with reviews of the ORSA as part of their risk-focused surveillance. The role of the ERM advisor is akin to a technical consultant and serves the states in an advisory capacity upon the request of a state insurance commissioner or their representatives. State laws generally authorize the commissioner to share ORSA-related information with the NAIC and other third-party advisors. Any regulatory activities relating to the ORSA are taken by the state insurance commissioner pursuant to the legal authorities granted to them under their particular state's law.

10. Are you on the NAIC Big Data (EX) Working Group?

Yes. I am a member of the NAIC Big Data (EX) Working Group.

11. The Big Data Working Group discussed at the last NAIC meeting a "proposed structure" that would "create a Predictive Analytics Team (PAT)" which would perform "initial model reviews assigned by the States ... of the model components of the filing ... after which it will either issue a report to the State in SERFF concerning its findings or issue an Objection Letter in SERFF to the filer requesting additional information. ... PAT will review the assigned models to determine, among other things: ... The level of correlation of model variables, individually or in combination, with State prohibited rating variables." Is NAIC considering with this proposal regulating in the field of interstate commerce?

No, the NAIC does not regulate interstate commerce and the proposal cited was from a discussion draft that remains under consideration and development.

12. Your state last year passed a statute requiring that, with respect to market conduct, "Any such examination may be conducted in accordance with the procedures and definitions set forth in the National Association of Insurance Commissioners' Market Regulation Handbook." Prior to that, did Connecticut use the NAIC Market Regulation Handbook in conducting such examinations? If so, under what authority?

Market conduct examinations are conducted pursuant to and in accordance with Connecticut law.

13. What edition of the NAIC Market Regulation Handbook are your examiners currently using? What edition will they use next year? Can your department use the 2017 Handbook, and next year the 2018 Handbook, in light of the Connecticut Supreme Court decision in Romanov v. Dental Commission (1955), that, "Where a particular statute is incorporated into another statute by specific or descriptive words, the presumption is that the legislature did not intend that modification or repeal of the adopted statute should affect the adoption statute"?

The Department performs market conduct examinations in accordance with applicable Connecticut law. The Market Regulation Handbook is not a statute and therefore is not impacted by the court decision cited.

14. Your state participates, including as a lead state, and signs the reports of multi-state market conduct examinations facilitated by the Market Actions Working Group ('MAWG') of the NAIC. Are these examinations prepared for and conducted at least in part in accordance with, as NAIC has described it, "a confidential, regulator-only Policy and Procedures Manual, separate from the Market Regulation Handbook, which outlines the procedures MAWG follows, the responsibilities for a state that refers an issue to MAWG, and the responsibilities for members of the lead state team that conduct the action"? If so, does Connecticut law specifically reference or authorize the use of this "confidential, regulator-only Policy and Procedures Manual, separate from the Market Regulation Handbook"? Under what authority does Connecticut's insurance department participate and sign off on the results of such multi-state examinations carried out under this confidential manual?

Market conduct examinations are conducted pursuant to and in accordance with Connecticut law.

15. As an Executive Committee member, you are on the NAIC board of directors. Have you signed the NAIC Conflicts of Interest Policy Acknowledgement & Disclosure Statement, which states that "Executive Committee members have a fiduciary duty to the NAIC which requires avoidance of conflicts"?

Yes.

16. The Policy prohibits conflicts or appearances of conflicts "with the business operations or regulatory support activities of the NAIC," a private enterprise. Does your "fiduciary duty" to the NAIC pose the appearance of a conflict with your fiduciary duty as a public official to the State of Connecticut and its citizens—given that private entity NAIC's "business operations" generate tens of millions of dollars a year for its $100 million budget through agreements and relationships with state agencies, including yours, such as through OPTins, SERFF, and NIPR; you are responsible to the NAIC to make sure that your domestic companies pay their database fees; and your agency pays membership dues to the NAIC?

No. There is no actual nor appearance of a conflict of interest. The services you cite *provide significant value to my state and allow for more efficient and effective regulation of our domestic insurance sector in furtherance of my obligations to protect Connecticut insurance consumers.*

17. Did you disclose as a Conflict of Interest on your Acknowledgement & Disclosure Statement your position as Connecticut insurance commissioner? Do you have a "close financial relationship" (your salary) in "an entity or organization" (the Connecticut Department of Insurance) "which could be affected by a decision of the NAIC" (accreditation review)?

No. I did not disclose as a conflict of interest on my Acknowledgement and Disclosure statement my position as Connecticut Insurance Commissioner. My position as Connecticut Insurance Commissioner is not a conflict of interest under the NAIC's conflict of interest policy.

18. If "acceptance of a valuable gift, entertainment, services ... from any entity or organization that might benefit because of a member's connection with the NAIC" is a Conflict of Interest under the NAIC Policy, then isn't acceptance of trips from NAIC, a private entity generating substantial funds from the services it provides to your State agency, a conflict of interest as well?

No. As stated above, it is not a conflict of interest.

19. Does Connecticut have any laws, rules, or other authorities, which govern the insurance commissioner as a public official's relationship with the NAIC as described in the questions above?

No.