



Statement
of
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President/CEO
Columbia Mutual Insurance Company
on behalf
of the
National Association of Mutual Insurance Companies
to the
United States House of Representatives
Committee on Financial Services
Subcommittee on Housing and Insurance
Hearing on
**The Impact of International Regulatory Standards on the
Competitiveness of U.S. Insurers: Part II**

February 25, 2016

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

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Chairman Luetkemeyer, Ranking Member Cleaver and members of the Subcommittee, my name is Gary Thompson, and I am the President and Chief Executive Officer of Columbia Mutual Insurance Company. I also serve on the Board of Directors of the National Association of Mutual Insurance Companies (NAMIC) on whose behalf I am testifying today.

Columbia is a mid-sized insurance company based in Columbia, Missouri with direct written premium of over \$262 million. For over 140 years, it's been our mission to build enduring relationships with customers by providing value and exceptional service in fulfilling our promises.

NAMIC is the largest property/casualty insurance trade association in the country, with more than 1,400 member companies representing 40 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers.

NAMIC member companies serve more than 170 million policyholders and write nearly \$225 billion in annual premiums. Our members account for 54 percent of homeowners, 43 percent of automobile, and 32 percent of the business insurance markets.

Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

Both Columbia and NAMIC are very appreciative of this subcommittee's focus on international insurance issues over the past year and salute Chairman Luetkemeyer's efforts in crafting his discussion draft legislation. We have serious concerns about recent efforts to create international regulatory standards for insurance companies, and believe Congress should conduct strong oversight in this area in order to protect domestic insurance markets, companies, and especially policyholders. Strong legislation can help ensure this will happen.

Columbia is not an internationally active insurer, but our company, and companies like ours, are concerned about forcing uniformity across very different regulatory environments with very different economic and political goals. It is important to remember that the vast majority of US property/casualty insurers are not internationally active. In short, we worry about the potential negative impacts any international agreement could have on the domestic marketplace or the state-based regulatory system that has served consumer and insurer needs for more than a century.

International Regulation of Insurance

Over the last several years, the Financial Stability Board (FSB) has become an increasingly important and influential regulatory organization for the global financial

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services sector. Re-established 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, the Financial Stability Forum had a role of monitoring, coordinating, and communicating between 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 standards at home. It has also directly imposed its will on the policy development work of international standard-setting bodies, including the International Association of Insurance Supervisors (IAIS). The FSB is a group that is primarily made up of banking regulators. The members are not elected officials and they do not include any U.S. insurance regulators yet they seem to hold a great deal of global power.

The core role the IAIS has traditionally played is in crafting supervisory principles, standards, and guidance for its members, but especially to assist developing countries searching for a framework for insurance regulation. Prior to the financial crisis the IAIS focused mostly on its Insurance Core Principles, 26 broad themes for effective regulation. Historically, these principles were created as a resource for emerging markets developing regulatory structures, rather than a set of global rules. Following the financial crisis, the IAIS began to focus on global financial stability and producing an international framework for the supervision of large, complex, global insurance groups.

In 2012, the G-20 and FSB were focused on banks as well as identifying Global Systemically Important Financial Institutions (and Global Systemically Important Insurers [G-SIIs]) and developing a new regulatory framework for them. The FSB enlisted the help of the IAIS in identifying G-SIIs for designation and in crafting new regulations applicable to large global insurers. In the summer of 2013 the FSB met with IAIS leadership and informed them that, in addition to G-SIIs, other large internationally active insurance groups (IAIGs) should also adhere to a global consolidated capital requirement that was similar to the Basel II and III requirements for banks. The IAIS was ordered to design, field test and adopt such global capital requirements first for G-SIIs by the end of 2014 and then for the IAIGs by 2016. The pace of this edict was unreasonable and unworkable, but the IAIS leadership 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 identifying the problem the FSB was trying to solve, and without explaining why the decisions were made or why stakeholder comments were ignored. The most troublesome of these decisions include: a) the insistence on a highly detailed, prescriptive formula for the ICS that would be applied to all countries; b) the requirement that all countries use the same valuation/balance sheet without regard to the costs and implications; and c) 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.

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The specific direction in which the IAIS has moved presents other areas of concern:

- **Legal Entity Regulation** – The U.S. system of insurance regulation operates under the premise that a legal entity capital system is stronger and more protective of policyholders who rely on contractual commitments from the individual legal entity. The idea that group supervision and a capital requirement at the group level will create more sound regulatory protections ignores the impact on policyholders who rely on the legal entity from whom they decided to purchase insurance. Policyholders did not bargain for the transfer of group level contagion risk from one troubled legal entity within a group to a sound legal entity. While the legal contractual implications may vary between jurisdictions, this is a very important concept in the U.S. The recognition of the need for legal entity capital protection is critical and is something the IAIS seems to lack in its deliberations over the ICS. It should also be noted that this very system was tested in the Financial Crisis and performed well by any measure.
- **Fungibility of capital** – The movement away from the focus on supervision and capital requirements at the legal entity level raises questions about a supervisor requiring movement of capital between legal entities, also known as “fungibility” of capital. This is of considerable concern for companies that operate with a business model based on legal entities. One need go no further than imagining what might have happened in the case of AIG if regulators or the securities subsidiary entities with all of the contagion risk had been allowed to simply raid the capital from healthy insurance subsidiaries to try and address the problem. Legal entity supervision obviates the need for fungible capital at the group level, a fact that supporters of an ICS seem to simply ignore.
- **Accounting Standards** – NAMIC has advocated for a flexible, principles-based approach that considers the regulatory outcomes of each jurisdiction. The IAIS seems to be committed to producing a prescriptive capital formula based on the same accounting information. They are creating a unique accounting system for insurance capital that bears more similarity to that used in the European Union. U.S. companies rely on Statutory Accounting for insurance regulatory purposes and publicly traded company use U.S. GAAP for investors. Changes in accounting standards would be very costly and very disruptive. If the U.S. supervisory, corporate law, and accounting systems are required to change significantly to accommodate the new group capital requirements, this will create a significant competitive disadvantage for U.S. insurers.

Despite the goals of the IAIS to achieve a comparable ICS for all IAIGs around the globe, the application of the same capital standard to unique companies 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 unique features that influence the solvency of the companies doing business in that regulatory environment. Similarly, every insurance group has unique characteristics that cannot be fully captured in a

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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.

The Role of Congress in International Discussions

At present, the U.S. is represented at the FSB by the Federal Reserve Bank's Board of Governors (Fed), the Securities and Exchange Commission (SEC), and the Treasury Department. The U.S. representatives to the IAIS include the Fed, the Federal Insurance Office (FIO), the National Association of Insurance Commissioners (NAIC), and all 56 state/territory jurisdictions. It is imperative that the various representatives that engage in these international fora speak with one voice in defense of the U.S. market, existing regulatory structure, insurers, and especially policyholders.

Congress has a critically important role to play in helping ensure the U.S. is appropriately represented in these international discussions. Through transparency and awareness, along with legislation to help guide our federal agencies, lawmakers can help protect the robustly competitive insurance market in this country. Rather than walk down the path of global regulatory uniformity for uniformity's sake, Congress can create an open process for deciding what is the best structure for the U.S. constituents of the insurance marketplace, including consumers, taxpayers, insurance companies, agents, and others.

In considering what course of action to take, it is important to remember that the various stakeholders in these discussions have disparate interests and objectives. There are some regulators in other countries who sincerely believe they have superior supervisory systems in place and that all other jurisdictions should adopt their approach. In our opinion, former SEC Commissioner Daniel Gallagher was correct when he said:

It remains the height of regulatory hubris to assume that not only is there a single regulatory solution to any given problem facing our markets, but that a handful of mandarins working in an opaque international forum can find those perfect solutions. In reality, while such regulators may get some things right, they will most certainly get some things wrong — and, having coerced the world to do it all one way, it will go wrong everywhere.¹

There are also going to be insurance companies which are domiciled or do business internationally that see a benefit to streamlining the regulatory requirements across jurisdictions. However, a benefit to some companies could be detrimental to others. For example, because the new standards being contemplated are more similar to existing European standards, U.S. insurers will be placed at a competitive disadvantage relative to their European counterparts who already must comply with them. At a Senate Banking Committee hearing last year, Dr. Adam Posen, the president of the

¹ Remarks at the Harvard Law School Symposium on Building the Financial System of the 21st Century: An Agenda for Europe and the United States, April 15, 2015. <https://www.sec.gov/news/speech/building-the-financial-system-of-the-21st-century.html>

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Peterson Institute, suggested that insurers in Europe very much dislike their new regulatory system, Solvency II. However, because it seems inevitable, they have given up fighting it and instead back using international bodies to impose it on the U.S., Japan, and other global competitors.²

For domestic companies like mine, the chief concern is the eventual importation of foreign regulatory standards for all companies which supplant or duplicate existing standards that we know to be effective. Despite the fact that we do not do business internationally and the ICS would not apply to Columbia right away, we see this and other IAIS measures as a significant threat. The ICS is being developed with the intention of required global adoption. In the U.S., the implementation of the new standard would fall to the state insurance regulators. In the end, the idea that regulators would stop after only applying the standard to groups doing business internationally strains credulity. Inevitably, regulators will want all insurance groups using the same capital standards and at that point, it will apply to us.

We are urging Congress to weigh-in on this debate on the side of defending the existing state-based regulatory structure that we know to be time-tested and strong. The U.S. has the most competitive insurance market in the world and we must be careful to avoid undermining the existing regulatory system which fosters it.

The International Insurance Discussion Draft

Given the direction of many of the conversations at the IAIS, we believe that legislation from Congress is timely and appropriate. Since 2013, NAMIC has submitted comments and testified at the IAIS on numerous occasions to encourage IAIS members to listen to our perspective. We have met with state regulators and federal officials to urge them to make these arguments as well. While there has been some recent success resulting in a delay in the “ultimate” ICS standard, the IAIS is holding firm on many of the decisions it made in 2013.

It is clear to us that Congress needs to step in and clarify how it wants U.S. interests in international processes protected. For one, legislation must ensure that U.S. federal agencies engaged in international discussions regarding regulatory standards for insurance consult with Congress, state regulators, insurers, and consumers prior to, and during, negotiations. It must acknowledge that the outcomes of these international conversations are not binding on the U.S. and have no legal force unless enacted or promulgated by an insurer’s state of domicile or its functional regulator. It must provide guardrails around what can and should be discussed through negotiating objectives and prohibitions for the federal agencies representing the U.S. at these negotiations. Ultimately, it must make clear that our existing state-based regulatory system is effective and must be defended and preserved. The U.S. regulatory system must be

²Testimony at Senate Banking Hearing on “The Role of the Financial Stability Board in the U.S. Regulatory Framework, July 8, 2015. <http://www.banking.senate.gov/public/index.cfm/hearings?ID=A094AB96-17E2-47EF-B654-2CDA052BF765>

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recognized as the equal of every other country and any attempts to deem it otherwise should be dismissed out of hand.

The discussion draft legislation represents a good starting point for accomplishing these goals. We remain very appreciative of the work that Chairman Luetkemeyer and others have done thus far. We do however think that there are necessary improvements that need to be made to the bill before it is introduced. Additionally, we would not want to see the majority of the current provisions removed or weakened. Stakeholder unanimity is less important than ensuring that we get the policy right.

Below is a section-by-section outline of our specific comments on the bill text.

Section 2 - Findings

The findings section contains clear statements of Congress's views which we support on several important topics, including:

- The success of the state-based system of insurance regulation in the U.S. for 150 years
- The protection of policyholders has been the focus of regulation and ought to be the goal of any international standard-setting
- U.S. regulators ought to seek input from as many and as diverse a group of stakeholders as possible before representing the U.S. position abroad

It is imperative that the committee add another finding that makes it explicit that the international insurance regulatory standards at issue are not self-executing and are entirely without legal effect in the United States until implemented through the required federal or state legislative or regulatory process. The Fed may have the authority to impose certain supervisory requirements on insurers under its jurisdiction, however, neither the FIO nor the Fed have the authority to bind the U.S. state regulators or legislators to an international regulatory standard applicable to insurers not subject to Fed supervision. This point should be added to the findings in the bill.

Section 3 - Objectives for International Insurance Regulatory Standards

We believe Section 3 is one of the most important in the legislation. It should be clear to our federal representatives – and their negotiating counterparts – what is and is not on the table for negotiating. Providing negotiating objectives to be pursued helps focus the international discussions on the right issues while championing the U.S. system and protecting U.S. policyholders.

We support the included language to accomplish the following:

- Seek standards focused solely on the protection of policyholders as reflected in the U.S. solvency regime
- Promote a principles-based approach to insurance supervision, with a focus for capital adequacy on risk-based capital requirements
- Seek the most efficient and least disruptive way of assessing the capital adequacy of insurance groups

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- Seek the recognition of the U.S. solvency regime as functionally equivalent to foreign regimes
- Seek increased transparency for all negotiations and meetings of international standard-setting bodies such as the IAIS
- Ensure sufficient public notice and comment periods before any standard is finalized
- Hold negotiating positions at international standard-setting bodies only after achieving consensus with state regulators
- Ensure the merits of existing state-based capital standards are recognized and incorporated in any domestic or global insurance capital standard

These represent excellent objectives for U.S. negotiators and should not be objectionable to anyone who believes the U.S. system is effective.

We strongly urge the committee to revisit putting in place several negotiating prohibitions as well. The right language would bar those things which should not be open for discussion while at the same time not tying the hands of U.S. negotiators to participate in and shape the international debates in the appropriate ways. For example, U.S. negotiators should be directed to oppose the application of bank-like capital standards for insurance companies or to oppose new standards which would require fundamental changes to how U.S. insurers are currently regulated. We believe this type of language is a necessary addition to any effective bill.

Section 4 – Requirements for Adoption of Int'l Insurance Regulatory Agreement

This section, also one of the more impactful, appropriately lays out further requirements before the U.S. may “agree to, accept, establish, or enter into” a finalized international insurance regulatory standard. It states that:

- The draft text of the new standard must be published in the Federal Register for public comment for a period of 90 days
- The Fed must issue a final rule for its own domestic capital standard and do so with notice and comment period of at least 60 days
- A copy of the final text must be submitted to the House Financial Services and Senate Banking Committees for a period of 90 days

The public comment and layover provisions of this bill will help to ensure that there is sufficient transparency with respect to the specifics of any agreement that is being considered, and we are very supportive of these. We are also very supportive of the sequencing provision that mandates that the Fed establish its required capital standards before negotiating internationally on others. There has long been a shared concern over the influence international negotiations might be having on the eventual domestic standard.

Roy Woodall, the Independent Member with Insurance Expertise of the Financial Stability Oversight Council (FSOC), perhaps said it best: “Congress is right to be concerned about these ongoing efforts by foreign organizations that could be used to

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mandate changes in decisions that Congress has specifically left to our State regulators, or have been reserved for Congress itself to decide”³ If the Fed has not yet decided what it believes the best consolidated group capital standard to be, from what position is it negotiating in these international arenas? The sequencing provision brings the Fed's focus back to the U.S. insurers and market, where it should be.

In the latest iteration of the discussion draft, a “limited effect” clause was added under subsection(c). The intent of this provision seems to be in line with our overarching recommendation that the legislation make clear that the framework being created under the bill does not explicitly or implicitly suggest that the U.S. representatives to the IAIS or elsewhere have any authority to legally bind the country to a new standard. While we appreciate the inclusion of this language, we believe it needs to be further strengthened. We urge the inclusion of language that states unequivocally that the authority to implement a new international standard in the U.S. resides solely with the functional state regulators or, in the case of Systemically Important Financial Institutions (SIFIs) or Savings and Loan Holding Companies, with the Fed.

Section 5 – Reports

NAMIC supports all efforts to maximize the transparency of international standard-setting bodies. The bill requires Treasury and the Fed to submit both a report and testimony every six months to the Senate Banking and House Financial Services Committees on efforts with state insurance regulators with respect to global regulatory forums. The report and testimony is to include:

- A description of the insurance regulatory or standard-setting issues under discussion at international bodies including the FSB and IAIS
- A description of the effects that proposals could have on consumer and insurance markets in the U.S.
- A description of any position taken by Treasury, the Fed, or FIO
- A description of efforts by the aforementioned to increase transparency at the FSB and IAIS
- A description of how the negotiating objectives in section 3 are being met and if they are not, why not

All of the above would be useful information for Congress to have and we support this type of consultation with both chambers. We would recommend a further subject upon which to report, namely, a description of any federal or state law or regulation which might have to be enacted or amended if any proposal being discussed at international insurance regulatory or supervisory forums were adopted. We would further recommend that the committee specify that Treasury and Fed study the effects of any proposals on “consumer cost and choice for insurance products” in the U.S.

³ Testimony of Roy Woodall, House Financial Services Subcommittee on Housing and Insurance Hearing on “The impact of Domestic Regulatory Standards on the U.S. Insurance Market,” September 29, 2015. <http://financialservices.house.gov/uploadedfiles/hhrg-114-ba04-wstate-rwoodall-20150929.pdf>

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Of particular importance in Section 5 is the inclusion of a joint economic impact analysis by the Fed and Treasury to be concluded prior to agreeing to any new regulatory standard. This study would be open to a notice and public comment period and most importantly, it would be independently reviewed by the Government Accountability Office. It is clear that both the FSB and IAIS tend to move forward on regulatory initiatives without a full assessment of the impact on U.S. consumers and insurance markets. This analysis and third-party review will help ensure that the impact of agreeing to some of these standards will be fully understood before they are finalized.

Section 7 – Treatment of Covered Agreements

The Dodd-Frank Act empowered Treasury through the FIO and the United States Trade Representative to negotiate and enter into international “covered agreements” on insurance regarding prudential measures. A covered agreement is wholly created by and defined in Dodd-Frank; a newly created term for insurance and not a standard type of contract, covenant, understanding or rule, subject to existing and recognized practices and requirements. These agreements are between the U.S. and one or more foreign governments or regulatory entities and must “achieve a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.”

The scope of covered agreements is not well-defined, but they do have the power to preempt state insurance law if that law goes against the terms of the agreement. Exactly how these agreements will be negotiated, entered into, and applied are subject to general guidelines in Dodd-Frank, but questions remain concerning these agreements, their application, the rights of parties to participate in and/or challenge them, and the enforcement mechanism.

We remain very concerned about the mechanism of the covered agreement and believe they should be included under the guidelines and processes laid out in the bill. In previous iterations of the bill Section 7 did incorporate covered agreements under the scope of the bill, exempting the one currently being negotiated. We saw this as one of the more important provisions in the bill. Unfortunately, the latest version of the discussion draft moved covered agreements outside of its purview. With the authority to preempt state law built in, covered agreements are arguably more in need of monitoring, stakeholder input, and Congressional consultation and direction. We respectfully urge the committee to include covered agreements within the scope of the eventual bill.

Section 8 – Duties of Independent Member of Financial Stability Oversight Council

The FSOC – one of the more opaque extra-regulatory bodies currently in existence – remains a source of major concern for NAMIC members. We do however support the inclusion of the Independent Member with Insurance Expertise of the FSOC in international discussions regarding insurance regulation. The bill includes additional specific consultative authorities for this individual. In effect, it assures that the independent member will have the ability to:

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- Engage in international dialogue on insurance regulation
- Work with the FIO and Fed at the IAIS and become a non-voting member thereof
- Participate in discussions related to insurance at the FSB and provide for attendance and participation of state insurance commissioners
- Participate with the U.S. delegation to the Organization for Economic Cooperation and Development

NAMIC members support adding more voices with insurance expertise to international discussions that are taking place. Given the role that the Independent Member with Insurance Expertise plays in the designation of SIFIs at the FSOC, this inclusion is more than warranted.

Of particular importance to the insurance industry is the provision allowing state insurance regulators to attend FSB meetings. We have long been critical of the FSB which has no insurance expertise from the U.S. and little expertise from other countries other than the IAIS representatives that report to them (there are no U.S. state insurance regulators or lawmakers represented on the FSB). Having additional, functional insurance regulators in the room can only help the FSB arrive at better decisions when it comes to insurers and insurance markets. We wholeheartedly endorse the inclusion of this provision.

Conclusion

It is clear that allowing U.S. officials to negotiate and engage with international regulatory bodies without Congressional input and direction would be a mistake. The development of the ICS points to many outstanding concerns including an over-reliance on uniformity, disregard for fundamentally different regulatory and legal systems, and a lack of true consideration of potential costs.

NAMIC and its members are pleased with the direction this legislation is heading, but believe there are ways in which it still needs to be strengthened to facilitate a needed course correction. In particular, we believe any effective legislation must:

- Clearly acknowledge that any international standard is not self-executing and is entirely without legal effect in the United States until implemented through a federal or state legislative or regulatory process.
- Add language that prohibits U.S. representatives from agreeing to standards which would require any additional changes to current state or federal law.
- Revisit the inclusion of covered agreements under the bill's processes and requirements.

By adopting these and the other recommendations listed above, the committee can help protect the robustly competitive insurance market in this country by swiftly moving forward on impactful legislation.