

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

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

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

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## **Introductory Remarks**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## **Conclusion**

U.S. insurance regulators have a strong track record of effective collaboration and supervision, and the NAIC is committed to coordinating with our federal and international counterparts to help ensure open, competitive, and stable markets around the world. It is critical that we promote a level playing field across the globe through strong regulatory systems while recognizing that

there will continue to be different cultural, legal, and operational differences in regulatory regimes around the world. Consistency in regulation globally is important, but preserving regulatory independence and diversity of thought can also serve as a buffer against contagion or one-size-fits all behaviors by financial firms that can result from one-size-fits-all regulatory approaches. Congress has delegated insurance regulatory authority to the states so we have a continuing obligation to engage internationally in those areas that impact the U.S. state-based system, companies, and consumers. U.S. state insurance regulation has a strong track record of evolving to meet the challenges posed by dynamic markets, and we continue to believe that well-regulated markets, both here and abroad, make for well-protected policyholders. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.