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**TESTIMONY OF JOSEPH TORTI, III
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ASSOCIATION OF AMERICA (PCIAA)**

**“The Impact of International Regulatory Standards on the Competitiveness of
U.S. Insurers: Part II”**

**SUBCOMMITTEE ON HOUSING AND INSURANCE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES**

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Chairman Luetkemeyer, Ranking Member Cleaver and members of the subcommittee, I commend you for holding this important second hearing on “The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers” and appreciate the opportunity to provide testimony. Fairfax Financial Holdings Limited (“Fairfax”) is a global group of companies including insurers and reinsurers with significant operations based in the U.S. Our companies write “Main Street” commercial and personal property and liability insurance, as well as specialty insurance coverage including surety, long haul trucking, workers compensation and energy and agriculture related insurance. Fairfax’s international operations include offices in Asia, Europe and the Middle East and includes Odyssey Re, a U.S.-based reinsurer that provides reinsurance for risks in over 100 countries.

My name is Joe Torti. I am the vice president of Regulatory Affairs for Fairfax, testifying on behalf of the Property and Casualty Insurers Association of America – PCI. Fairfax is a member of PCI, which is composed of nearly 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than \$195 billion in annual premium and 35% of the nation’s home, auto and business insurance, with a membership epitomizing the diversity and strength of the U.S. and global insurance markets.

Until two months ago, I was the Rhode Island Superintendent of Banking and Insurance, so I can provide a broad perspective on the interplay of banking, insurance, regulators and the insurance industry.

PCI supports the Subcommittee's efforts to draft consensus bipartisan legislation clarifying its intent on insurance regulation and international representation and appreciates and supports the Chairman's ongoing leadership and evolving legislative drafts.

Congress in the Dodd-Frank Act affirmed the state-based regulation of insurance and the McCarran-Ferguson Act and the states' historic focus on consumer and policyholder protection. But there have been a number of emerging gray areas as the new regulatory roles have evolved where additional Congressional clarity could be very helpful. For example, Congress abolished the Office of Thrift Supervision and transferred its authorities over thrifts with insurance affiliates to the Federal Reserve Board. But the Federal Reserve has taken a dramatically different approach to its supervisory role than the OTS, including actively participating in the International Association of Insurance Supervisors (IAIS) together with the newly created Federal Insurance Office (FIO) and numerous state insurance regulators. The Dodd-Frank Act includes a brief reference to FIO's role at the IAIS, but provides no guidance as to how the Federal Reserve, FIO and states should work together, what their goals should be, and how they should defend the U.S. insurance regulatory system internationally.

I can tell you from personal experience as both a bank and insurance regulator that the two supervisory perspectives can be dramatically different, for example on issues such as capital leveraging and liquidity risk, or the more holistic issues of macro-economic stability versus policyholder protection. Congress recognized the need to address the regulatory divergence and provide more guidance with passage of the Insurance Capital Standards Clarification Act two years ago, clarifying that the Federal Reserve Board can apply insurance-based capital standards – rather than bank-centric rules – to the insurance activities of insurance holding companies it supervises. The Luetkemeyer draft legislation similarly clarifies the intent of Congress on international issues to follow a more insurance centric approach for insurance issues, including collaborating with the state insurance regulators and seeking greater equivalent recognition of the U.S. insurance regulatory system internationally.

Our state and federal representatives negotiating international insurance standards do their best to represent their agencies and ultimately the United States, but they have very different perspectives, constituencies and priority objectives. For example, in 2008 the Department of the Treasury in its Blueprint for a Modernized Financial Regulatory Structure recommended an optional federal charter. The Federal Reserve is in the process of creating a consolidated supervisory system for entities within its jurisdiction, essentially creating a second layer of holding company oversight. The states have generally opposed federal regulation of insurance except in limited instances. And yet all three with their very different regulatory perspectives and goals are in some manner representing the United States at the IAIS in the development of global insurance standards that could have profound implications for the future of our regulatory system.

Congressional oversight has been very helpful to the evolving U.S. process, particularly in encouraging regulatory cooperation and transparency. By working towards and considering bipartisan legislation Congress can help ensure that our Team USA regulators have the same priorities and objectives and greater Congressional clarity in carrying out their missions. This in turn will improve the likelihood of efficient and effective outcomes in international insurance regulatory deliberations that will serve consumers and maximize competition and innovation. PCI therefore appreciates the interest and leadership by members of the Subcommittee and full Committee towards that end.

The State-Based Insurance Regulatory System Has Been Successful Because It Is Consumer Focused.

For nearly 150 years, the states have regulated insurance and coordinated their activities through the National Association of Insurance Commissioners. As a former chief regulator from the State of Rhode Island and chair of one of the NAIC's most important committees, I know what effective regulation requires and how very well my state colleagues have performed in good times and bad, including during the financial crisis of 2008-2009.

While it has not always worked perfectly, the overall performance of the state-based regulatory system compares favorably with that of any other financial services regulation. In terms of size, degree of consumer protection, financial strength and amount and diversity of competition, the U.S. state-based insurance regulatory system is unmatched by any insurance regulatory system. We are pleased therefore that the draft legislation being considered by this committee begins its findings with a recitation of this fundamental reality.

This success is not just an accident or an historical anomaly. The U.S. insurance regulatory system has been so successful because it focuses on the end user—the consumer. So we strongly support Congressional emphasis on the importance of putting consumer protection first, as does our state-based regulatory system.

The U.S. Needs to Speak with One Voice in International Regulatory Discussions.

In recognition of the strong performance of state regulation, Dodd-Frank reiterated the primary role of the states in insurance regulation. However, it also created the Federal Insurance Office (FIO) in the Treasury, which under Title V is to coordinate federal policy and represent the Secretary of the Treasury, as appropriate, at the International Association of Insurance Supervisors. The FIO Director has since assumed a leadership role at the IAIS, chairing one of its two most important committees. In addition, Dodd-Frank gave the Federal Reserve Board regulatory authority over insurers with thrifts and those designated as systemically important. Based on this regulatory authority, it, too, is an active member of the IAIS. Meanwhile, the NAIC and states also serve on IAIS committees and the states have the largest amount of technical expertise in all areas and are legally responsible and accountable for the health and regulation of the markets in their states.

Unfortunately, without more Congressional guidance on their objectives and priorities, our U.S. and state representatives can have conflicting perspectives and priorities, for example taking three

different positions on whether to eliminate consumer group and stakeholder involvement in IAIS working groups. Both transparency and accountability have since suffered.

Accordingly, we support Congressional clarity to encourage greater collaboration and consensus among the regulators, requiring the regulators to work towards achieving consensus on policy positions in all international insurance regulatory discussions, backed up by reporting mandates. Congress often requires joint rulemakings or actions by agencies with overlapping jurisdiction. Federal agencies often fail to achieve such consensus within the statutorily required time, continue working on the issues in the meantime, and under Congressional pressure eventually get to the same page. While agreement among multiple agencies can be difficult, it is a critical effort to assure all representatives of the U.S. speak with one voice. It strengthens that voice and also increases the likelihood that any international standard will be effective and worthy of serious consideration. While there is no penalty in the bill that would tie the agencies' ability to take action to working together, Congress can and should set the appropriate goals and required eventual outcomes to ensure a cooperative approach.

Transparency and Accountability Are Often Lacking in International Regulatory Discussions.

As previously noted, the IAIS voted in 2014 to close its working group meetings, with a few rare exceptions, thereby reducing the ability of U.S. companies and consumers to participate meaningfully in the process. Every bit as important, the Financial Stability Board, which was given extremely broad powers by the G20 ministers to set the regulatory agenda for all financial services sectors including insurance, operates behind closed doors with an occasional invitation to selected companies. The Treasury, Fed and SEC are the sole representatives of the U.S. and the states are not present, even when insurance regulatory issues are considered.

Because transparency is a core value and is fundamental to our system, and because it produces the best over-all outcomes, it is critically important that Congress act to reverse the trend toward closing doors and excluding interested parties unless they have been blessed by the powers that be—often not U.S. regulators. The NAIC holds open meetings and conference calls of virtually all of its working groups and offers a good model of openness that has contributed substantially to the success of our system.

The draft legislation strongly encourages increased transparency, establishing greater transparency as a negotiating objective and providing specific procedures to assure transparency and accountability, for example public notice and comment periods in connection with the congressional layover provisions. The draft would also require special and periodic reports on transparency. While the specific requirements of the bill have been evolving, we support the efforts to provide greater clarity of Congressional expectations for increased transparency and accountability.

The other element of transparency that Congress should address is the current lack of information from federal agencies before, during and after international insurance regulatory deliberations at the IAIS, FSB and elsewhere. Congress makes the laws and has a unique role in protecting McCarran-Ferguson and setting the boundaries and limits for federal involvement in insurance.

Congress is kept regularly involved in international trade negotiations and the draft bill would appropriately require a measure of accountability to Congress for international standard setting negotiations as well.

The Need for Increased Mutual Recognition and Congressional Oversight of International Agreements

The EU, the second largest insurance market in the world, is now beginning implementation of Solvency II, a novel insurance regulatory approach based in part on global banking standards that reflect Europe's more concentrated and interconnected market, its tradition of greater intervention into the private sector, and the need for a more one-size-fits-all common market standard. Solvency II's approach and structure is fundamentally different from the time-tested state-based insurance regulatory system in the U.S. that is more focused on consumer protection and supported by extensive data reporting and guaranty funds in every state. It may be the right system for Europe, but has already proven enormously expensive with all of the Team USA representatives suggesting that portions such as required market valuation of liabilities would not be beneficial to U.S. consumers.

Unfortunately, Solvency II contains a requirement that companies from "third countries" including the U.S., be treated differently unless the third country is deemed to be equivalent, a highly prescriptive process. The U.S. understandably, and in consideration of the success of our different and time tested system, refused to submit to that process. Just before Solvency II implementation, UK regulators demanded extensive data reporting from U.S. companies, reaching beyond Europe to the U.S. holding companies, thereby impliedly giving extraterritorial effect to Solvency II. And it is not clear what steps other European regulators may take against our companies.

We are pleased that Treasury and USTR have indicated that they will push for recognition of U.S. regulation by the EU in connection with their discussions with the EU and do not intend to exceed their negotiating authority with respect to agreeing to domestic regulatory changes. While the draft legislation has been evolving in this area, we appreciate the Congressional vigilance and encouragement of the desired outcome.

Conclusion

Since the enactment of Dodd-Frank, the international insurance regulatory world has evolved in ways that may not reflect congressional intent to protect the strength and competitiveness of the U.S. insurance market and its consumer focused state-based regulatory system. We commend the Congress for its efforts to date and urge you to move forward with bipartisan legislation that includes the Luetkemeyer draft to improve international insurance regulatory deliberations and outcomes and clearly and effectively promote U.S. markets and our state-based insurance regulatory system.