Statement

of

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to the

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Housing and Insurance

Hearing on

Legislative Proposals to Reform Domestic Insurance Policy

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Introduction

The National Association of Mutual Insurance Companies is pleased to provide testimony on a number of important legislative proposals that are of critical importance to the property/casualty insurance industry.

NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,400 regional and local mutual insurance member companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. Member companies serve more than 135 million auto, home and business policyholders, writing in excess of $196 billion in annual premiums that account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. More than 200,000 people are employed by NAMIC member companies.

We are pleased that the committee is focusing on issues related to the property/casualty insurance industry, which is highly competitive, well capitalized, and a key pillar in the strength and resilience of the American economy. The property/casualty insurance industry pools the liability, property and casualty risks of U.S. businesses and consumers, enabling them to profitably engage in commerce. Property/casualty insurers pay out more than $400 billion each year in policy benefits, helping individuals and businesses rebuild their lives. The industry also contributes to the growth and stability of the economy by investing more than $1.4 trillion, principally in corporate and government bonds and stocks; serves as a major source of capital for state and local governments; and generates 2.3 million U.S. jobs, more than one-quarter of which are directly employed by insurance companies. The property/casualty industry is unique among the financial services industry and it is imperative that policies are adopted that do not needlessly disrupt one of the well-functioning bedrocks of our financial structure by adding additional costs or creating competitive disadvantages.

The committee is examining a number of legislative proposals that would directly impact the property/casualty industry. NAMIC appreciates the opportunity to offer comments on each of the following proposals.

> H.R. 4510, the Insurance Capital Standards Clarification Act of 2014, which would afford the Federal Reserve greater flexibility to apply accurate capital standards for insurers.
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> H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013, which would clarify that the FDIC does not have the authority to assess insurance companies for the Orderly Liquidation Authority ("OLA").

H.R. 4557, the Policyholder Protection Act of 2014, which would extend the policyholder protections of the Bank Holding Company Act to bank-affiliated insurance companies organized as thrift holding companies.

H.R. __, the Insurance Data Protection Act, which would revoke the authority of the Federal Insurance Office ("FIO") and the Office of Financial Research ("OFR") to subpoena data from insurance companies, and,

H.R. __, the Risk Retention Modernization Act of 2014, which would expand the authority of risk retention groups to offer other commercial lines insurance.

H.R. 4510, the Insurance Capital Standards Clarification Act of 2014

The Insurance Capital Standards Clarification Act, or H.R. 4510, amends Section 171 of the Dodd-Frank Act (DFA) to clarify the application of capital requirements to insurance companies subject to supervision by the Federal Reserve Board.[1] Under the DFA, insurance companies that own savings and loan holding companies and insurance companies that are designated as "systemically important" by the Financial Stability Oversight Council are subject to supervision by the Federal Reserve Board. Section 171 of the Dodd-Frank Act separately requires that the Federal Reserve Board impose certain minimum leverage and risk-based capital requirements on the companies that it supervises. The Federal Reserve Board has interpreted Section 171 to require the application of bank capital rules (the so-called Basel III capital standards) to the insurance companies it supervises, despite numerous legal opinions that they have flexibility in this regard and the insistence of the author of the provision, Sen. Susan Collins of Maine, that she never intended to have bank capital standards apply to insurance companies. Sen. Collins and a number of members of the House and Senate have urged the Federal Reserve Board to adjust the capital standards for insurance companies to align with the business of insurance rather than the business of banking, but the Federal Reserve Board maintains that it is confined by the language of Section 171.

The Insurance Capital Standards Clarification Act resolves this question by stating that, in establishing the minimum leverage and risk-based capital standards under Section 171, the

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

Federal Reserve Board or any banking agency is not required to include or consolidate in the depository institution holding company the assets and liabilities of any regulated insurance entity that is engaged in the business of insurance and is subject to state-based insurance capital requirements or capital requirements imposed by a foreign country. The legislative clarification is narrowly tailored and preserves the Federal Reserve Board's authority to impose capital standards on insurance companies under other provisions of Federal law, including the Board's authority in Section 165 of the DFA to impose heightened capital standards on nonbank financial companies designated by the Financial Stability Oversight Council for Federal Reserve Board supervision. All non-insurance activities of an insurance company supervised by the Federal Reserve Board would remain subject to bank capital standards.

This Act would make clear the legislative intent of Section 171, by recognizing that bank capital standards are not appropriate for insurance companies. It is widely acknowledged that insurance business risks are not the same as the risks associated with the business of banking. The risks in the business of insurance are not highly correlated to the macro-economic cycles and are found on the liability side of the balance sheet; existing capital standards imposed by state regulators appropriately address these risks by focusing predominantly on liability and underwriting risk. Banking risk, on the other hand, is based on the asset side of the balance sheet and includes credit, market, counterparty, and liquidity risk. Bank capital rules are designed to address these risks and ensure that a bank has sufficient funds meet depositor demands.

The Act also provides that the Federal Reserve Board shall not require insurance companies subject to Section 171, that only prepare financial statements in compliance with state-based statutory accounting rules, to also prepare financial statements in compliance with generally accepted accounting principles (GAAP). Since the early 1900s, state insurance regulators through the National Association of Insurance Commissioners (NAIC) have maintained their own accounting system, commonly known as statutory accounting principles (SAP). SAP are derived from GAAP, but are tailored with a regulatory focus on solvency to more accurately and more conservatively assess insurers than can be done using GAAP. Each insurer must use statutory accounting to file its financial statements with the regulators in those states in which the insurer is licensed to do business**.**

Although every publicly traded company, including insurers, must file GAAP statements with the Securities and Exchange Commission, many mutual insurance companies prepare financial statements using SAP only. Forcing such companies to prepare GAAP statements in addition to SAP is a labor intensive, multi-year project that will cost companies hundreds of millions of dollars without adding any benefit in regulating the company. The legislative history of the DFA is clear that insurance companies should be regulated as insurance companies, including explicit Senate Report language that such treatment should extend to accounting standards.

Despite clear congressional intent, the Federal Reserve has indicated on numerous occasions that its preference and intention is to force non-publicly traded insurance companies to adopt GAAP to conform with the Fed's standards in regulating banks. H.R. 4510 would reaffirm the congressional intent that in cases where a top-tier holding company is an insurance company itself and only files SAP financial statements in accordance with state law, the company should not be compelled to prepare GAAP financial statements. The clarification is necessary to ensure that the Federal Reserve does not impose needless new expensive and burdensome accounting requirements on insurance companies which would add costs for policyholder-owners, while providing no additional regulatory benefit.

NAMIC has provided Congressional testimony and numerous comment letters to the Federal Reserve Board and other regulators noting that bank capital standards are wholly inappropriate for insurance companies, and that the application of banking standards to insurance companies operates to the detriment of insurance policyholders, insurance companies and the stability of the financial system. NAMIC has also consistently defended the use of statutory accounting and opposed proposals to impose GAAP reporting. The Insurance Capital Standards Clarification Act is much needed legislation to resolve once and for all the issue of application of capital standards to insurers and the use of statutory accounting principles. NAMIC encourages the committee to move forward with adoption of the legislation as soon as possible.

H.R. 4557, the Policyholder Protection Act of 2014

The Bank Holding Company Act (BHCA) establishes procedural requirements for federal banking regulators seeking to transfer or move assets from an insurance company organized as a bank holding company (BHC) to a troubled affiliated bank.[2] Known as the "Source of Strength" doctrine, the BHCA requires that a BHC or Savings and Loan Holding Company (SLHC) or other non-BHC or SLHC controlling an insured depository institution serve as a source of financial strength for the underlying bank or association. Specifically, the BHCA prohibits the transfer of funds if the state insurance regulator notifies the holding company and the Federal Reserve Board in writing that such action would have a material, adverse effect on the financial condition of the insurance company. The act further requires the board to promptly notify the insurance regulator of the intent to seek the transfer of funds or assets from an insurance company.

Insurance companies are subject to very strict capital and reserving requirements, conservative accounting standards, and stringent investment rules to ensure they maintain the financial wherewithal to meet their financial obligations. State insurance laws and regulations create walls

[2] Section 5(g) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(g))

around the licensed insurance operations of diverse financial firms to ensure that funds used to support the solvency and security of the insurance units are not raided to support non-insurance operations elsewhere within the control group. Even where a property/casualty insurer is held by a holding company that also holds other types of financial services companies, these regulatory restrictions designed to protect policyholders operate to "ring-fence" the property/casualty insurer's capital and protect it from incursions caused by problems in other subsidiaries. The solvency and financial security of the insurance company underlying its policies is the ultimate consumer protection. It is imperative that insurance assets are protected to pay claims.

The BHCA refers to BHCs and SLHC; however, most insurers affiliated with banks are organized as thrift holding companies, not bank holding companies. The laws governing thrift holding companies do not provide the same procedural protections as the BHCA. The Policyholder Protection Act of 2014 would amend the BHCA to provide the same protections for insurance companies organized as thrift holding companies.

NAMIC has long supported insulating the funds and assets of insurance companies within consolidated control groups. We remain concerned about any attempt to use insurance assets designed for the protection of policyholders and claimants to offset activities in other affiliated organizations. Tapping the assets, particularly without the consent of the insurance regulator, would inappropriately threaten the financial structure underpinning the insurance operations and undermine consumer confidence in the insurance industry. The BHCA protections should be extended to thrift holding companies and NAMIC supports H.R. 4557.

H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013

The Insurance Consumer Protection and Solvency Act of 2013, or H.R. 605, clarifies that the Federal Deposit Insurance Corporation (FDIC) does not have the authority to assess insurance companies for the Orderly Liquidation Authority. The DFA created an orderly liquidation process, and Section 210 of the Dodd-Frank Act directs the Treasury Department to establish an Orderly Liquidation Fund (OLF) that will be managed by the FDIC. If the funds recouped from claimants are insufficient to satisfy the obligations to the Secretary, then the FDIC may assess "eligible financial companies" and certain other financial companies, as necessary, for the FDIC to repay obligations issued to the Treasury Secretary within 60 months of the issuance of such obligations. "Eligible financial companies" include any bank holding company with total consolidated assets equal to or greater than $50 billion and any nonbank financial company supervised by the Board of Governors.

The orderly liquidation process established by the DFA is designed to ensure timely, organized and orderly resolution of troubled financial institutions. However, the state-based resolution authority for insolvent property/casualty insurers is a thoughtful, methodical process with a superb track record of protecting insurance claimants and policyholders and the Act recognizes that insurance insolvencies should be resolved through that process. All states have

property/casualty insurance guaranty funds that safeguard their residents against the insolvency of a property/casualty insurer doing business in the state. In the event of an insurance insolvency in which there are insufficient funds to pay claims, state guaranty funds assess member insurers to pay obligations related to the insolvency. As such, the insurance industry bears the financial responsibility for its own liquidation regime and the state guaranty system continues to work well to protect consumers without the need for taxpayer bailouts.

In addition to the fact that the insurance insolvencies are resolved under a self-supporting system, there is near unanimous agreement that traditional property/casualty insurers pose no systemic risk to the nation's economy. The International Association of Insurance Supervisors, (IAIS) in its November 2011 report on Insurance and Financial Stability, found that "insurers engaged in traditional insurance activities were largely not a concern from a systemic risk perspective" as a result of the specific nature of the insurance business model and in the way insurance liabilities are funded and claims are settled.[3] In fact, the IAIS concluded that insurers provide "an important contribution to the financial soundness of banks and more broadly to financial stability." The findings were echoed by the 2011 Annual Report of the Financial Stability Council which found that "insurance institutions were only indirectly affected by the crisis" and that "the traditional U.S. insurance market largely functioned without disruption in payments to consumers throughout the financial crisis and the recovery."[4] Highlighting the performance of the insurance industry the same report found that "only 28 of approximately 8,000 insurers became insolvent in 2008 and 2009, and those insurers are being resolved pursuant to applicable state law."

As NAMIC made clear in its February 18, 2014 comments to the FDIC, under the DFA, the regulations defining the OLF must take into account the differences in risks posed to the financial stability of the United States by financial companies; the differences in the liability structures of financial companies; the different assessment bases for financial companies addressing their own industry liquidations; and consider specifically that insurance companies are already assessed pursuant to applicable state law for the costs of the rehabilitation, liquidation, or other state insolvency proceedings and contribute to guaranty funds to pay the losses incurred by policyholders of insolvent insurance companies. There is uniform recognition that property/casualty insurance companies and mutual companies in particular present almost none of the risk factors the FDIC is statutorily required to apply and that all insurance companies already meet guaranty fund obligations for the insolvencies in their own industry.

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[3] "Insurance and Financial Stability," International Association of Insurance Supervisors (IAIS), November 2011. <http://www.iaisweb.org/temp/Insurance_and_financial_stability.pdf>
[4] 2011 Annual Report, Financial Stability Oversight Council (FSOC), August 2011. <http://www.treasury.gov/initiatives/fsoc/Documents/FSOCAR2011.pdf>

It is not appropriate to assess insurance companies for the financial bankruptcies of non-insurance financial institutions, and NAMIC strongly supports H.R. 605. We urge the committee to act expeditiously to ensure that the nation's insurance consumers do not bear the financial responsibility for the failures of non-insurance financial institutions.

H.R. __, the Insurance Data Protection Act

Section 502(e) of the DFA grants authority to the Federal Insurance Office (FIO) to receive and collect data and information on and from the insurance industry and insurers, though it is directed to coordinate with federal or state regulators and research publicly available sources prior to requesting the information. The FIO is granted subpoena power subject to a written finding by its Director that the information is necessary and that the office has coordinated with the appropriate state regulator. The Office of Financial Research (OFR) is similarly granted subpoena authority to collect information.

The Insurance Data Protection Act would elevate the authority to subpoena information directly from insurance companies to the Secretary of the Treasury, strengthen the confidentiality protections for the information and require reasonable reimbursement for the costs of compliance with the data production.

Data calls and document productions are costly and time-consuming endeavors for insurers and raise issues related to the confidentiality and security of the information. Insurers regularly submit detailed information to state regulators on all aspects of their operations. Publicly traded insurance companies also provide data to securities regulators and government regulated exchanges. NAMIC has long supported and encouraged harmonization and coordination of the information requests among the states. Imposition of an additional reporting layer is counter to the goal of simplification and coordination. NAMIC recognizes the need for information at the federal level, but believes that collection of information should be limited.

The data collection and review mandates of the FIO and the OFR is expansive, and the amount and extent of the data potentially subject to these mandates is virtually limitless. While information to be learned about insurance through these information collection activities can be useful, neither the FIO, nor the OFR, serves in a regulatory capacity. As such, the information subject to their collection initiatives is not enforcement-related and is generally more long-term and academic in nature.

The Insurance Data Protection Act would not deny the FIO or the OFR any relevant information, but would ensure they take reasonable steps to prevent unnecessary and duplicative reporting by insurance companies. NAMIC believes that the reasonable safeguards proposed in the Insurance Protections Act in no way impede the functions of the FIO or the OFR and afford many of the

protections recently highlighted in the White House's Big Data and Privacy Working Group Review. NAMIC supports the Insurance Data Protection Act.

H.R. __, the Risk Retention Modernization Act of 2014

The Liability Risk Retention Act,(LRRA) enacted in the 1980s in response to a liability insurance crisis, effectively preempted state insurance laws and provided for the creation of risk retention groups (RRGs) to provide coverage in all U.S. jurisdictions. The LRRA currently permits RRGs to underwrite commercial lines liability coverage excluding workers' compensation, and does not apply to personal lines coverage. Under the Act, risk retention groups that meet certain licensing requirements of one state may operate nationwide. Except for the RRG's chartering state, the risk retention group is exempt from any state law, rule, or regulation that regulates or makes an RRG unlawful (with certain exceptions, including compliance with fraudulent trade practices regulations, nondiscrimination, and unfair claim settlement practices, and participation in state guaranty funds).

The Risk Retention Modernization Act proposes to expand the application of RRGs to all forms of commercial insurance other than group health, life, disability, or workers compensation insurance. We do not believe that current market conditions warrant a national and permanent expansion of RRGs into property or other non-liability insurance. The admitted market is fully capable of providing this coverage. Further, fair competition demands a regulatory environment that ensures that all businesses – large, medium and small – can operate according to the same set of clearly defined rules and standards. Unless competing parties abide by the same rules, competition becomes artificial and unbalanced.

Application of competition and regulatory principles in a manner that does not discriminate between or among economic entities in like circumstances and providing like goods and services is essential to a healthy, vibrant and competitive marketplace. The proposed legislation, by establishing different regulatory standards based on the corporate structure of the provider, does not meet the consistency and equality standards necessary to ensure fair competition. NAMIC, therefore, opposes the Risk Retention Modernization discussion draft.

Conclusion

NAMIC applauds the committee for considering a number of issues critical to the insurance industry. NAMIC urges the committee to support H.R. 4510, the Insurance Capital Standards Clarification Act of 2014; H.R. 605, the Insurance Consumer Protection and Solvency Act of 2013; H.R. 4557, the Policyholder Protection Act of 2014; and the Insurance Data Protection Act. We look forward to working with the committee to advance these proposals as expeditiously as possible.