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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of the

National Association of Mutual Insurance Companies

to the

United States

House Financial Services Subcommittee

On Monetary Policy and Trade

Hearing on

The Financial Stability Board's Implications for U.S. Growth and Competitiveness

September 27, 2016

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide comments to the House Financial Services Subcommittee on Monetary Policy and Trade on the Financial Stability Board's implications for U.S. growth and competitiveness, in particular the growth and competitiveness of the property/casualty insurance industry.

NAMIC is the largest property/casualty insurance trade association in the country, with more than 1,400 member companies representing 39 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 more than $230 billion in annual premiums. Our members account for 54 percent of homeowners, 43 percent of automobile, and 32 percent of the business insurance markets.

Introduction

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, the precursor organization 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 rules at home.

Beyond the overreach of a group of mostly foreign policymakers exerting their vision of regulation on our banking system, it 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."[1] NAMIC wholeheartedly agrees.

Multilateral organizations like the FSB have always been intended to promote and foster economic growth, not to regulate financial services markets everywhere in the world. NAMIC and its members firmly believe the FSB actions on insurance regulation have in fact inhibited, and are likely to continue to inhibit, growth and competitiveness for the U.S. insurance industry.

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[1]Dr. Adam Posen, Testimony before the U.S. Senate Banking Committee, July 2015, Page 8. http://www.banking.senate.gov/public/_cache/files/b9f2617a-7440-45a8-8632-58b5c2206739/33A699FF535D59925B69836A6E068FD0.posentestimony7815.pdf

Specifically, NAMIC has significant concerns with many of the activities at the FSB, to say nothing about the opaque processes by which they are conducted. Two of the chief concerns we would like to focus on include:

- The FSB's review and guidance of the policy development work of international standard setting bodies, specifically the International Association of Insurance Supervisors (IAIS) and;
- The designation process of Global Systemically Important Insurers (G-SIIs) and its influence on the Financial Stability Oversight Council's (FSOC) designation of Systemically Important Financial Institutions (SIFIs) here in the U.S.

NAMIC believes the current U.S. state-based insurance regulatory system is robust and well-positioned to meet the needs of the nation's insurance marketplace. All NAMIC member companies – those that are domestic-only and those that are internationally active – will feel the impact of the international standards and regulatory decisions being imported to the U.S. Indeed, the movement toward more formulaic, prescriptive standards from abroad seems to be accelerating.

The FSB Structure and Process

The Plenary of the FSB is housed in Basel, Switzerland, in the Bank for International Settlements, and has been chaired by various central banks. It is the sole decision-making body of the board and operates on the basis of consensus instead of actual voting. That, however, is all that is known about the decision-making process at the FSB. The U.S. is represented on the FSB by the Treasury Department, the Federal Reserve, and the Securities and Exchange Commission (SEC). Interestingly, there are no U.S. state insurance regulators or lawmakers represented on the FSB, and there is no formal process for communicating the concerns of NAMIC members, or anyone else, to those U.S. representatives.

Further, the Plenary is dominated by central banks and political appointees. Consequently, there is ample reason to doubt that the Board fully understands how its decisions affect insurance markets, or that the critical differences between banking and insurance are fully appreciated. As a result, most of the regulatory concerns and proposed solutions tend to be very bank-centric. The decisions to designate G-SIIs and to craft a new global consolidated capital standard for all Internationally Active Insurance Groups (IAIGs) are being made by an organization with almost no insurance expertise from the U.S. and little expertise from other countries other than the IAIS representatives that report to them.

This lack of insurance expertise is best illustrated by an FSB meeting in 2016 when representatives of U.S. Guaranty Funds and companies were invited to participate in discussions about potential resolution strategies and plan requirements. During the questioning of the invited experts it was clear that the basic guaranty fund structure and U.S. insurer assessments for deficiencies were unknown to the FSB members charged with decision-making on insurance issues. Incredibly, some were even surprised to learn that the guaranty fund system was funded by the insurance companies rather than

taxpayers. This was further evidence that this board is not equipped with the facts and the understanding of our robust insurance regulatory environment.

Finally, it is important to note that neither the FSB nor the IAIS are bound by due process and neither formally considers the costs of the changes they are making to international insurance standards relative to the presumed benefits of these changes. With each new or revised standard, costs are added from international regulatory enforcement and compliance with seemingly little regard for the impact of these costs on governments, insurers, and consumers.

Financial Stability Board Driving Action on New Insurance Capital Requirements

In 2012, the G-20 and FSB were focused on banks as well as identifying Global Systemically Important Financial Institutions (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 with the crafting of new regulations for them. Without warning or clear reasons, in the summer of 2013 the FSB met with IAIS leadership and informed them that, in addition to G-SIIs, other large IAIGs should also 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 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 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.

Since 2013, NAMIC has submitted comments and testified at the IAIS on numerous occasions to encourage IAIS members to listen to a different 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" standard, the IAIS is holding firm on many of the major policy decisions it made in 2013.

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.

The costs to the U.S. will be substantial. In fact, through this process our country is being asked to consider major, unnecessary, and ill-fitting changes to its supervision, corporate law, and accounting systems to accommodate the new group capital requirements. Because the new standards being contemplated are largely derived from existing European standards, U.S. insurers will be placed at a competitive disadvantage relative to their European counterparts. Indeed, some have suggested that is entirely the point:

> The insurers in Europe for the most part rightly hate [European Standards], but since it seems inevitable to be imposed on them, they have given up fighting Solvency II, and instead back using the FSB to impose it on the US, Japanese, and other competing insurers. They figure if they will be limited, they want to be sure their global competitors are as well. The US needs to stand up against this in the FSB.[2]

NAMIC has asserted that a *successful* global effort should not create unnecessary competitive asymmetries between 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.

Unfortunately, the IAIS still seems to be fighting the idea of flexibility. For the time being they are willing to field test options that include a variety of accounting systems, but they have not agreed that the ultimate ICS could include differing approaches. Implementation of the ICS may well favor the local approach of one jurisdiction over another, creating further disproportionate costs between similarly situated companies. The potential market disruptions could be unintended, but very significant. Although they originally were not going to, it now appears that the IAIS is moving forward with a cost benefit analysis, though the FSB did not bother to do so.

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[2] Dr. Adam Posen, Testimony before the U.S. Senate Banking Committee, July 2015, Page 10. http://www.banking.senate.gov/public/_cache/files/b9f2617a-7440-45a8-8632-58b5c2206739/33A699FF535D59925B69836A6E068FD0.posentestimony7815.pdf

The FSB Influence on the FSOC SIFI Designation Process

Following the financial crisis, the FSB determined to identify large, international, non-bank financial firms whose failure could threaten the global financial system and designate them for enhanced regulation. These designations and enhanced standards would be developed in consultation with the IAIS and presumably then implemented by the countries of domicile for the designated company. Following the passage of the Dodd-Frank Act in 2010, the U.S. established its own process for this type of designation of Systemically Important Financial Institutions by the Financial Stability Oversight Council. The FSOC would vote and the designated company would be subjected to supervision and enhanced regulation by the Federal Reserve.

We believe that designations of systemic importance should be made by individual jurisdictions with appropriate due process, transparency, and accountability. This is to avoid what we have seen happening at the FSB. Through incredibly opaque processes, the Board appears driven to designate a group of the largest insurers as G-SIIs just for the sake of designating insurers. Designations should be based on actual systemic risk, not just a selection of the largest companies in each sector. The entire FSB process requires more sunshine, clearer focus on actual systemic risk, and a clear path towards adequately de-risking to avoid a designation or to get out from under one in the future.

There is further reason to be concerned about FSB influence on the FSOC designation process. Despite the fact that most insurance experts agree that traditional insurance activities are not systemically risky, on July 18, 2013, the FSB designated nine large international insurers – including U.S. insurers AIG, Prudential, and MetLife – as G-SIIs. Although the FSOC had just days before designated AIG, Prudential was not designated a SIFI until September 2013, and MetLife was not designated until December 2014. We have significant concerns that the sort of deliberative process put in place by Congress when it authorized the FSOC to make SIFI designations was circumvented and instead processes with pre-determined outcomes were implemented.

As mentioned above, the Plenary of the FSB makes its decisions by consensus. It is simply unfathomable that this group would move ahead with the designation of U.S. firms over the objections of the U.S. representatives. This means that the Treasury Department, Federal Reserve, and SEC all concurred in the decision to designate AIG, Prudential, and MetLife. In the case of MetLife and Prudential, this also means that these decisions were reached *before* the FSOC had conducted its supposedly fair, objective, and evidence-based designation process. Three members of the FSOC – the Federal Reserve, Treasury Department, and the SEC – had already made their decision months before. Perhaps this unusual process explains in part why a federal court has seen fit to overturn the MetLife designation as arbitrary and capricious.

Further, the U.S. insurance industry and its regulatory system are underrepresented at the FSB, with no involvement or consultation by the functional state regulators of the actual U.S. insurance entities of those designated G-SIIs. When the FSOC designations of Prudential and MetLife were made, they were done over the objections of the one voting member of the Council with insurance expertise, Roy Woodall as well as the

state regulator on the council, John Huff. As stated earlier, the court has since overturned the MetLife designation.

Mr. Woodall has stated in congressional testimony that he has a "concern that international regulatory organizations may be attempting to exert what I consider to be inappropriate influence on the development of U.S. regulatory policy."[3] NAMIC believes the evidence clearly demonstrates that he is right to be concerned.

Conclusion

In conclusion, the FSB actions on insurance capital requirements and its influence on the FSOC SIFI process have not been positive, and have in fact inhibited, and are likely to continue to inhibit, growth and competitiveness for the U.S. insurance industry. NAMIC believes it is important to ensure that federal agencies representing the U.S. on the FSB and at the IAIS are advancing policy positions that represent the interests of U.S. insurance consumers, insurance markets, insurance regulators, and the U.S. economy in general. To that end, the U.S. should insist on an open and transparent policy development process, and the U.S. representatives who engage with international bodies should share a common agenda and a common message. That message should include a strong defense of the U.S. insurance market and existing regulatory structure. It should also promote the interests of U.S. insurers and their policyholders.

Congress has a critically important role to play as these international discussions continue. Through oversight and awareness, along with the possible enactment of legislation to facilitate a needed course correction, lawmakers can help protect the robustly competitive insurance market in this country. NAMIC applauds the Committee for holding this important hearing.

[3]Roy Woodall, Testimony before the U.S. Senate Banking Committee, April 2015, Page 3. http://www.banking.senate.gov/public/index.cfm/hearings?ID=29608126-AE85-4568-87B2-14E1A61D9774