THE NEW ENGLAND COUNCIL

Committee Update

May 1, 2015

This Week in Washington: Spotlight on Insurance

This week saw two key Congressional panels consider the role of both U.S. and international capital standards for insurance companies, and a standing-room event with key Congressional representatives diving into the future of insurance regulations. On Tuesday, the Senate Banking Committee held a hearing with insurance regulators on capital standards. Later that day, the DC publication *National Journal* played host to both Senate Banking Committee Chairman Richard Shelby (R-AL) and House Financial Services Housing and Insurance Subcommittee Ranking Member Emanuel Cleaver (D-MO) – along with a panel of experts – for an in-depth look at regulatory matters for the insurance industry. On Wednesday, the aforementioned House subpanel turned its attention to the topic of international capital standards. And on Thursday, a Senate Banking Subcommittee took a look at capital standards at the role of the Financial Stability Oversight Council (FSOC). A summary of each event, in chronological order of occurrence, may be found below.

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HEARING: The State of the Insurance Industry and Insurance Regulation

Senate Committee on Banking, Housing, and Urban Affairs

Tuesday, April 28, 2015 at 10:00 a.m.

Hearing materials may be found here.

WITNESS LIST

- **The Honorable S. Roy Woodall, Jr.**
  Independent Member with Insurance Expertise
  Financial Stability Oversight Council
- **Mr. Mark Van Der Weide**
  Deputy Director, Division of Banking Supervision and Regulation
  Board of Governors of the Federal Reserve
- **Mr. Michael McRaith**
  Director
  Federal Insurance Office, U.S. Department of the Treasury
- **Mr. Kevin McCarty**
  Commissioner
  Florida Insurance Department on behalf of the National Association of Insurance Commissioners

SUMMARY

Chairman Richard Shelby (R-AL) asked Mr. Van Der Weide where the Fed is on capital rules for insurers in light of the Collins Amendment fix being signed into law. He responded that the Fed is in the data collection, engagement, and analysis phase right now, but offered no timeline on when any proposed rule will come out. Shelby also stated that if the U.S. is going to participate in international discussions, we should speak with one voice, and call for policy that adheres to U.S. insurance rules. Mr. McRaith responded that the FIO coordinates with both states and the Federal Reserve, and also believes that it is essential we work together and coordinate.

Ranking Member Sherrod Brown said that a new Goldman Sachs survey find U.S. insurers are looking to invest in less liquid assets and outsource investments to third party asset managers; he asked how the NAIC is monitoring this. Mr. McCarty said that regulators are examining ways to address, while Mr. McRaith said this demonstrates the need for diligence at state regulatory level. On shadow insurance, Ranking Member Brown said that the revised NAIC proposal is not adequate in the minds of many, to which Mr. McCarty noted that they are still engaged in the process and have a sincere desire to close loopholes and end abuses in captive system moving forward. Mr. McRaith noted that the proliferation of captives is a real concern, and they highlight differences between the states, leading to a "race to the bottom."

Mr. McCarty told Senator Mike Rounds (R-SD) that the Dodd Frank Act left the state regulatory framework in place, recognizing the success they have had in regulating the industry. He said that NAIC's Holding Company Act would be comparable to what is being used around the world.

Senators Jon Tester (D-MT) and Dean Heller (R-NV) talked about legislation they have introduced to bring accountability and transparency to the international insurance process. The *International Insurance Capital Standards Accountability Act* (S. XXX) would establish an Insurance Policy Advisory Committee on International Capital Standards at the Federal Reserve and require the Fed and the FIO to report annually on activities at the IAIS and FSB. The Fed and the Treasury Department, in consultation with NAIC, would also have to complete a study on the impacts on consumers and markets in the U.S. before supporting any international insurance proposal or international insurance capital standard.

Another part of the Heller-Tester bill would be to support efforts to increase transparency and public observer access to IAIS working groups and meetings. Senator Tester questioned Mr. Van Der Weide as to why the public isn't allowed to observe all of the IAIS's technical sessions, while Senator Heller made it a point to decry the IAIS' updated transparency efforts are lacking.

Senator Elizabeth Warren (D-MA) discussed her new investigation into brokers and advisers who take "kickbacks" to sell "lousy products to unsuspecting families," such as annuities to those nearing retirement. She noted that commissioned salespeople have received free cruises, luxury vacations, iPads, Mercedez Benz leases, etc. as rewards for selling particular financial products. Warren said she sent letters to 15 largest annuity companies and asked them to release information on perks offered to brokers and advisers in return for selling a particular product.

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EVENT: The Future of Financial Services and Insurance: Risk and Regulation at Home and Abroad
National Journal
Tuesday, April 28, 2015 at 1:30 p.m.

More information on the event may be found here.

PANELISTS

- **U.S. Senator Richard Shelby (R-AL)**
  Chairman, U.S. Senate Committee on Banking, Housing, & Urban Affairs
- **U.S. Representative Emanuel Cleaver (D-MO)**

Ranking Member, House Financial Services Subcommittee on Housing and Insurance

- **Aaron Klein**
  Director, Financial Regulatory Reform Initiative, Bipartisan Policy Center
- **Andrés Portilla**
  Managing Director, Regulatory Affairs, Institute of International Finance
- **Therese Vaughan, Ph.D.**
  Dean, College of Business and Public Administration, Drake University

SUMMARY

Senator Shelby and Rep. Cleaver were the keynotes for the event. Shelby did not discuss the insurance industry in depth, while Cleaver offered only a few points on the industry, chief among them that he believes it would be helpful for the industry to have a single or near universal position on capital standards. Based on meetings he has held, it seems that there are a variety of positions within the industry. Additionally, he pointed to a letter that he wrote, along with Subcommittee Chairman Blaine Luetkemeyer (R-MO) to Federal Reserve Chair Janet Yellen in February regarding implementation of S. 2270, the Insurance Capital Standards Clarification Act, urging the Fed to avoid using Basel bank-centric capital framework for insurers. The duo said that a capital regime should take into account the unique characteristics of the insurance business model, including accounting systems, insurer liabilities, valuation standards, and hold-to-maturity practices. They also urged Chair Yellen to ensure that no policy principles are agreed to internationally that would restrict the ability to implement the legislation in accordance with the intent of Congress. Both believed that changes could be made to the Dodd Frank Act to provide regulatory relief to smaller firms.

The panel discussion was more focused on the insurance industry and capital standards. Aaron Klein stated that the Federal Reserve is now the federal regulator for nearly one-third of the life insurance industry and a quarter of the property and casualty insurance industry. The Dodd Frank Act closed the Office of Thrift Supervision (OTS) and transferred its powers to the Federal Reserve, an agency which does not have much expertise in regulating the insurance industry. As a result, Klein said that Fed is now realizing how much of a challenge this newfound responsibility is.

Therese Vaughan said that the Federal Reserve can't help looking at the insurance industry through a banking lens given its history. She noted the agency's "obsession with policyholder runs," and said that the Fed lacks an appreciation for the differences between the banking and insurance industries, because the insurance industry is built on a long-run view.

Andrés Portilla said that the problem with Federal Reserve oversight of the insurance industry is that they are looking at individual firms, and not activities. He wants to give the Fed the benefit of the doubt that they will be able to properly supervise the insurance industry, but Aaron Klein responded that they have had five years to prepare for this responsibility, and he questioned how many people with insurance expertise they have hired, and what they have done to prepare.

Therese Vaughan noted that the state regime has done a pretty good job of protecting consumers, and that concentrating regulatory authority does not always lead to better results. All panelists noted the need to appreciate the differences between U.S. and European markets.

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HEARING: The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers
House Financial Services Subcommittee on Housing and Insurance
Wednesday, April 29, 2015 at 10:00 a.m.

Hearing materials may be found here.

WITNESS LIST

- **Mr. Michael McRaith**
  Director, Federal Insurance Office
  U.S. Department of the Treasury
- **Mr. Mark Van Der Weide**
  Deputy Director, Division of Banking Supervision and Regulation
  Federal Reserve Board of Governors
- **Mr. Kevin McCarty**
  Commissioner, Florida Office of Insurance Regulation
  on behalf of the National Association of Insurance Commissioners

SUMMARY

The hearing featured three of the four panelists from the Senate Banking Committee hearing a day earlier. Mr. McCarty told Chairman Blaine Leutkemeyer (R-MO) that he's concerned about the aggressive timeline of the IAIS in establishing global capital standards, and he wants to make sure

American institutions have ample time to field test. Mr. Van Der Weide said it's more important to get the standards right than done quickly, and as a U.S. representative to the IAIS, he's committed to that.

Rep. Michael Capuano (D-MA) asked witnesses to cite which federal law allows federal agencies to regulate non-bank non-SIFIs; after silence, he said there is none, and is concerned that the U.S. is negotiating federal standards for companies they cannot regulate. Mr. McRaith says his goal is to influence international standards so that they reflect the best interests of the U.S. insurance industry. Rep. Capuano said if we're going to have federal regulations on insurance companies, it should be done through Congress; he fears the IAIS expects the U.S. to adopt capital standards wholesale, based on what he's read.

Ranking Member Emanuel Cleaver (D-MO) asked each witness to give one benefit of global capital standards. Mr. Van Der Weide said achieving a level playing field across the world; Mr. McRaith said they will give further opportunities to U.S. companies to enter into overseas markets where regulators are looking for a common "language." When asked about potential negatives, all referenced either bad or unworkable regulations that don't have U.S. interests in mind.

Rep. Roger Williams (R-TX) said that he wishes the state regulators were able to be at the table as a part of the discussions over international capital standards. Asked about his opinion of the FIO's performance, Mr. McCarty told Williams that he believes the FIO is only interested in the best interest of the United States.

Mr. Van Der Weide told Rep. Dennis Ross (R-FL) that he expected the IAIS to do impact studies of international standards, and that cost-benefit analysis would need to be done in the U.S. prior to adoption of any standards to ensure they work for the U.S. industry.

Mr. McCarty told Rep. Al Green (D-TX) of his concerns over the Financial Stability Board (FSB), because many of the international members of the FSB have a bank-centric point-of-view. Mr. McCarty also noted that, while state insurance regulators supervise the entire private insurance market in the U.S., they have only had "limited access into FSB discussions directly relevant to our sector."

Rep. Sean Duffy (R-WI) said that he introduced legislation on Thursday called the *International Insurance Standards Transparency and Policyholder Protection Act* (H.R. 2141). The bill establishes a Congressional notification timeline and public comment period on any international insurance regulatory framework and requires consultation with state insurance regulators.

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HEARING: Examining Insurance Capital Rules and FSOC Process
Senate Banking Subcommittee on Securities, Insurance, and Investment
Thursday, April 30, 2015 at 10:00 a.m.

Hearing materials may be found here.

WITNESS LIST

- **Mr. Robert M. Falzon**
  Executive Vice President and Chief Financial Officer
  Prudential Financial, Incorporated
- **Mr. Kurt Bock**
  Chief Executive Officer
  Country Financial
- **Mr. Daniel Schwarcz**
  Associate Professor
  University of Minnesota Law School

SUMMARY

Subcommittee Chairman Mike Crapo (R-ID) stated at the outset of the hearing that the topics to be covered included the Federal Reserve's implementation of the Collins Amendment fix, the FSOC non-bank SIFI designation process, and international capital standards.

In his testimony, Mr. Falzon said that it is important to get domestic standards right before agreeing to any international standards. He said that the FSOC's process does not make clear how to reduce systemic footprint; while companies have an opportunity every year to petition FSOC for de-designation, more meaningful information to support the initial designation, and how to become de-designated, is essential.

Mr. Bock noted that the state system of supervision has done a good job over 150 years, and wonders if Congress truly intended for Fed supervision of the insurance industry. The property-casualty industry has serious concerns about recent international standard setting efforts that have morphed far beyond their original mission to develop best practices or principle-based standards. Instead, he said, these bodies are increasingly trying to extend particular capital standards and accounting practices used by certain regions on a global basis that could significantly undermine the current U.S. insurance regulatory system. Mr. Bock also said that IAIS decisions are made behind closed doors, leading to a lack of transparency. He posits that insurers are told not to worry as global standards will not have force of law in the U.S., but still has concerns.

Mr. Schwarcz said the nature of systemic risk is too fluid, complex, and poorly understood to allow for simple formulaic responses. He believes that the FSOC has done a reasonable job of promoting the transparency of its designation process given the inherently multi-factored and complex nature of its responsibility. However, as a way to improvement performance, he believes the FSOC should be clear in what features render designated companies a SIFI and how to get out of that designation. He also said he believes that the Fed should consider implementing a capital regime for insurance SIFIs that is consistent with three broad principles. First, that regime should use as its starting point the consolidated balance sheet of the firm. Second, the Fed should seriously consider designing its capital regime for insurance SIFIs to require valuation of assets at market rates. And third, the Fed should not allow firms to use their own internal models to determine adequate capital levels..

In response to a question from Chairman Crapo, Mr. Schwarcz said that the reason insurance companies can be designated as SIFIs is that sometimes long-term liabilities can seem, or become, short-term in systemic circumstances; however, Mr. Falzon replied that Prudential demonstrated that was not the case in their defense against SIFI designation.

Senator Elizabeth Warren (D-MA) noted that Europe and the U.S. have very different approaches to regulating insurance companies, and asked witnesses how the European regulatory approach compares to the U.S. approach? Mr. Falzon said that the U.S. is largest insurance market in world, and that the European models is based on business model and accounting construct that they have, which are different and not well suited to how the U.S. regulates insurers. Mr. Schwarcz said that it does make sense for the Fed and state supervisors to tailor rules to fit the existing regulatory structure in the U.S. Tying global capital standards to the ongoing trade talks, Warren expressed her concern that if regulatory changes are included in future trade agreements with the E.U., the U.S. may lose its ability to tailor rules to our industry.

Chairman Crapo asked if it is a valid concern that same thing will happen with capital standards as did with SIFI designation, where it appears that FSB designation of a G-SIFI predetermined the FSOC's designation of a SIFI in the U.S., Mr. Falzon said that it is difficult to know because both processes lack transparency. Mr. Schwarcz said he believes the U.S. regulators should learn from the IAIS and from their European colleagues, but that they should not adopt the IAIS' standards wholesale and he doubts that will happen.

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