



**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES**

**HEARING ON "CAPITAL MARKETS REGULATORY REFORM: STRENGTHENING INVESTOR
PROTECTION, ENHANCING OVERSIGHT OF PRIVATE POOLS OF CAPITAL, AND
CREATING A NATIONAL INSURANCE OFFICE"**

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**Testimony of
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Thank you, Chairman Frank, Ranking Member Bachus, and members of the Committee.

My name is Stef Zielezienski. I am Senior Vice-President and General Counsel of the American Insurance Association (AIA), a national trade association whose property-casualty insurance company members write business in every U.S. jurisdiction and throughout the world. I appreciate the opportunity to be here today to discuss a topic of great importance to AIA and its members – the establishment of a federal insurance office within the Treasury Department, as contemplated in the “Federal Insurance Office Act of 2009” H.R. 2609 Discussion Draft offered by Representative Kanjorski (Discussion Draft).

As this Committee is aware, AIA has long advocated a national regulatory alternative to the state-by-state framework of supervision that exists today. While the Discussion Draft does not create a national functional insurance regulator, the Federal Insurance Office, if structured correctly, would represent a substantial contribution toward broadening and deepening our nation’s understanding of the critical role of insurance in our financial system. The Office would also substantially improve the representation of the United States in international insurance-related negotiations. As such, AIA supports the Discussion Draft as a strong and important step forward along our shared journey to bring the U.S. insurance regulatory system into the 21st century.

I will focus my remarks today on two major themes that capture these principles, and offer some suggested amendments to the Discussion Draft that would enable those principles to be fully realized.

Federal Insurance Expertise

Because property-casualty insurance now represents a significant part of our national economy and supports the resiliency of U.S. homeowners, businesses, local governments and others, it is clearly time for the federal government to develop its own insurance expertise. Insurance contributes 2.4% to the annual GDP, with property-casualty insurance accounting for more than \$535 billion in capital, purchasing close to \$370 billion in state and municipal bonds, paying almost \$250 billion annually in claims and, importantly, directly or indirectly employing 1.5 million hard-working Americans. The Treasury white paper recognized that “[i]nsurance plays a vital role in the smooth and efficient functioning of our economy” and is a “major component of the financial system.” (U.S. Department of the Treasury, “Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation”, p. 39 (June 16, 2009) (White Paper)).

In many ways, it is the engine that propels commerce and innovation, protecting individuals and businesses against adverse events leading to loss, and enabling them to meet financial demands in the face of adversity. And the unique focus of property-

casualty insurers on reducing societal risk has saved hundreds of thousands of lives, prevented millions of injuries, and avoided hundreds of billions of dollars in economic losses.

For these reasons alone, given its role as a key segment of our national economy, the federal government must create and empower an office that understands how the insurance industry works (including how it handles risk, utilizes capital, and meets the needs of its customers), understands the issues that confront it, and assesses whether it is regulated appropriately. The proposed Federal Insurance Office will be a significant advance in carrying out these functions. In recognition of the importance of insurance to our national economy and the duties outlined in the Discussion Draft, we believe the Federal Insurance Office should be led by an Assistant Secretary of the Treasury who would be appointed by the President and confirmed by the Senate, like the heads of other federal offices that are responsible for the several financial services sectors. By having this position filled by a presidential appointee, the head of the Federal Insurance Office will be recognized domestically as well as internationally as serving an important role as a senior government official with insurance sector responsibilities, bringing more influence to the position.

The Discussion Draft also makes a significant investment in developing such expertise by granting the Office the authority to “monitor all aspects of the insurance industry....”

(Discussion Draft, § 313(c)(1)(A)). Implicit in this function, as detailed in the Discussion Draft, the Office has authority to gather information from insurers and a wide variety of government and industry sources. In exercising this authority, the Discussion Draft recognizes the current state regulatory system by requiring the Office to make every effort to leverage information insurers already provide to government sources, in order to prevent duplicative or burdensome requests. With respect to information collection from those sources, this principle is already reflected in the “advance coordination” language of the Discussion Draft (§ 313(e)(4)); yet there is no similar provision that applies to data gathered from non-governmental sources. The Discussion Draft should be amended to add parallel language covering such sources.

With respect to maintaining confidentiality protection or privileges that attach to non-public information gathered by the Office, the “confidentiality” section of the Discussion Draft does a good job of preserving those protections, as well as protecting information submitted as part of a regulatory agency report. (Discussion Draft, § 313(e)(5)). However, the Discussion Draft should also provide protection for commercially sensitive information or trade secrets that are provided to the office, whether that information comes from a governmental or non-governmental source. As a result, we recommend amending the Draft to confirm that such information is considered subject to the confidential information and trade secret exemption from public disclosure under the Freedom of Information Act, 5 U.S.C. § 552(b)(4).

In its role as federal insurance expert, the Discussion Draft also envisions that the Office will (a) identify “issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system,” (Discussion Draft, § 313(c)(1)(A)) and (b) make recommendations to the Federal Reserve as to whether any insurer (including affiliates of such insurer) should be designated as a “Tier 1 Financial Holding Company” for purposes of additional supervisory and regulatory scrutiny. (Discussion Draft, § 313(c)(1)(B)).

We agree that this is an important function for the Federal Insurance Office. With respect to property-casualty insurance, the Office should start with the premise that this sector has successfully weathered the current crisis and remains strong overall today. It remains strong for a number of reasons, including the fact that property-casualty insurance operations are generally low-leveraged businesses, with lower asset-to-capital ratios than other financial institutions, more conservative investment portfolios, and more predictable cash outflows that are tied to insurance claims rather than “on-demand” access to assets.

Given this result, the Office should serve as a resource not only to Congress, but to the federal banking agencies and to the Administration to facilitate understanding of the regulatory model that applies to insurance companies and to ensure that the insurance industry and its customers are not adversely affected by the application of inappropriate regulatory standards. This is a concern with respect to some of the legislative

recommendations that are part of the Treasury proposal, particularly where those recommendations apply bank regulatory models to insurance companies.

This is not to say that the current system of insurance regulation is perfect or that insurance companies should not be part of a systemic risk monitoring regime. To the contrary, as the Treasury white paper notes, the state-by-state system of insurance regulation is “highly fragmented, inconsistent, and inefficient.” (White Paper at p. 40). Equally important, and despite good intentions, the states are inherently limited in their ability to resolve issues that cross state and national borders. But, until Congress decides to establish a national functional insurance regulatory alternative – a resulting structure that AIA would welcome – the expertise promised through the Federal Insurance Office is essential to prevent the unintended consequences to the insurance marketplace that may flow from indiscriminately applying bank-centric regulation to insurers, particularly because insurers are already subject to strict cradle-to-grave regulation and supervision.

In addition to the authority included in the Discussion Draft, we would urge the Office to target its surveillance activities to identify un- or lightly-regulated products or activities (which do not include traditional property-casualty insurance products) that could present systemic risk to other institutions or sectors of the financial system and U.S. economy. After all, it was these types of activities and regulatory gaps that led to the need for a federal rescue of AIG. By directing its attention to identifying and analyzing

such activity, this approach would allow the Office to monitor the insurance sector in a way that is not distracted by company size, but measures companies and the industry through the prism of risk aggregation and counterparty exposure generated by non-traditional products or activities, and identifies any regulatory gaps that have the potential to create systemic risk.

We recognize that the current state-based insurance regulatory system is not well-suited to bridge information or regulatory gaps that may arise where a financial conglomerate that includes traditional insurance subsidiaries engages in non-traditional financial activities. Such non-traditional activities exceed the jurisdiction of state insurance regulators and may span multiple federal regulatory regimes. The resulting information and regulatory gaps are often cited in connection with the AIG meltdown. In addition to other elements of the Administration's proposal, the Federal Insurance Office represents a tangible step toward identifying and closing those gaps.

Regarding the Office's relationship to any federal systemic risk council that may be established, we strongly urge this Committee to provide a seat for the head of the Federal Insurance Office on the council – as recommended earlier, the Assistant Secretary of the Treasury for Insurance. While traditional property-casualty insurance activities do not present substantial systemwide risk, any council should not operate without access to insurance expertise. Insurance is too important a sector in our nation's economy to be left out. Providing the head of the Office with a recognized seat

at the table would afford the council a federal stakeholder offering a national and international perspective on insurance issues that is not available to either the National Association of Insurance Commissioners (NAIC) or any individual state insurance commissioner or group of commissioners. In turn, providing the Office with a position on the council would advance that Office's charge to explore more fully the interplay between insurance and the other financial services sectors and enhance its monitoring function. In addition, serving on the council would engage the Assistant Secretary in discussions of developing and emerging issues so that any potential impact on insurance could be minimized or avoided altogether.

International Authority on Insurance Matters

Significantly, the Discussion Draft vests the Federal Insurance Office with the authority "[t]o coordinate Federal efforts and establish Federal policy on prudential aspects of international insurance matters...." (Discussion Draft, § 313(c)(1)(D)). That authority includes the ability to represent the United States in the International Association of Insurance Supervisors (IAIS) and complements separate power in the Discussion Draft for the Treasury Secretary to negotiate international insurance agreements relating to prudential measures. (See Discussion Draft, §314(b)).

These are important and necessary functions, given that the U.S. Constitution vests the federal government – not the states or the NAIC – with exclusive power to conduct

foreign affairs. Both the Discussion Draft and the Treasury white paper document ongoing frustrations with the inability of the United States to negotiate authoritatively with foreign counterparts on pressing insurance issues. The Discussion Draft notes that “[t]here is increasing tension in the current regulatory systems as the result of an absence of clear and settled means for governments to enter into agreements on prudential measures with respect to the business of insurance or reinsurance.” (Discussion Draft, § 314(a)). The white paper reinforces the point, stating that “the lack of a federal entity with responsibility and expertise for insurance has hampered our nation’s effectiveness in engaging internationally with other nations on issues related to insurance.” (White Paper at pp. 39-40).

The Discussion Draft ensures that state insurance regulation will come into alignment with at least prudential matters established in international agreements. While the term “prudential” is not defined in the Discussion Draft, in this context, it appears reasonable to equate the term with “financial regulation” by looking at (1) the use of the term in other aspects of the Treasury reform package, (2) the goal of addressing systemic risk in the United States and globally, and (3) the Draft’s purpose to break the logjam caused by the lack of U.S. negotiating authority.

First, Title II of the Treasury proposal contemplates additional financial regulation for those institutions the failure of which would present a threat to the U.S. economy or to financial stability. In doing so, this title requires the systemic risk regulator to prescribe

“prudential standards” for such entities that include factors such as risk-based capital requirements, leverage limits, liquidity requirements, and risk management requirements. (See “Title II – Consolidated Supervision and Regulation of Large, Interconnected Financial Firms,” § 204). All of these “prudential” factors are components of financial regulation.

Second, one primary purpose of establishing the Federal Insurance Office is to identify and mitigate risk that threatens the stability of our financial system. As we have painfully learned in the current crisis, such risk does not stop at our borders, but can have a domino effect for institutions and economies around the globe. Viewed in this context, it is clear that the Office’s international authority over prudential insurance measures must involve a comparative ability to engage with foreign nations on financial regulatory issues that may address the risk of financial or economic instability on an international scale.

Third, to reinforce this point, Treasury’s white paper discusses the importance of the Office’s international role, using Solvency II, the recently adopted European Union insurance solvency framework, as its primary example of a global insurance issue that requires the U.S. to be represented with a single authoritative national voice. Solvency II is intended to make European companies more globally competitive by creating an efficient and uniform standard for all E.U. Member States and encouraging, while

carefully overseeing, new developments in risk management intended to spur competition and innovation.

Solvency II is now moving forward. Simultaneously, other major insurance markets, such as Switzerland and Bermuda, have instituted, or are in the process of instituting, very similar systems. In sharp contrast, the current U.S. insurance regulatory system remains fragmented among 57 state and territory level jurisdictions, and their regulators have forcefully objected to adopting Solvency II's innovative, pro-competitive aspects.

As Treasury noted in its white paper, an important part of Solvency II involves a third country "equivalency" determination: "In addition, the European Union has recently passed legislation that will require a foreign insurance company operating in its member states to be subject to supervision in the company's home country comparable to the supervision required in the EU." (White Paper at p. 40).

High level European spokespersons have repeatedly stated that the equivalence determination will not be made state-by-state, but rather will be made at the national level. At this time, it is hard to see how the current U.S. insurance regulatory system could pass this test. And, considering that Europe is one of the three largest insurance markets in the world, a failure by the U.S. regulatory system to be deemed equivalent, could negatively impact the global competitiveness of U.S. insurers and the jobs that

activity generates in the United States. At minimum, the United States should be fully empowered to sit at the negotiating table and engage with their foreign counterparts while Solvency II discussions evolve.

Solvency II's equivalency test highlights the disparity between financial regulatory regimes that will determine whether U.S. insurers doing business in Europe will be treated equally with insurers domiciled in other countries or will be disadvantaged abroad. It is but one example of the urgent need to empower the Federal Insurance Office and Treasury to engage on so-called prudential insurance regulatory matters to protect U.S. economic interests and to preserve the global competitiveness of the U.S. insurance industry.

Indeed, linking the authority of the Secretary and the Office with the critical insurance policy issues being discussed at the international stage, we believe that the Discussion Draft compels a conclusion that the Office has the ability to pre-empt state insurance measures that are inconsistent with international agreements concluded on behalf of the United States to the extent those agreements involve financial supervision.

Because the United States must speak with one voice on insurance regulation and policy at the international level, we strongly urge this Committee to expand the Office's representative capacity beyond the IAIS. The IAIS is not the only international organization that deserves an authoritative U.S. presence in this regard. Broad financial

services regulatory reform discussions are taking place in a number of international forums, and the United States must be part of those discussions, with a clear mandate and the most credible representation on international insurance matters.

Let me close by thanking the Committee again for circulating Representative Kanjorski's Discussion Draft and for engaging in an open dialogue on the substantial merits of a robust Federal Insurance Office. Establishing such an office – properly empowered – represents a necessary first step in ensuring that the essential role of insurance is recognized at the national level, and that the federal government retains the ability to preserve a viable private insurance market and maintain U.S. competitiveness in a changing global economy.