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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of the

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Hearing on

The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers

June 13, 2013

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide comments to the House Financial Services Committee on international insurance regulatory issues and the impact on U.S. insurers.

We represent the interests and concerns of 1,400 property/casualty insurance companies serving more than 135 million auto, home and business policyholders, with more than $196 billion in premiums accounting for 50 percent of the automobile/ homeowners market and 31 percent of the commercial insurance market. We are the largest and most diverse property/casualty trade association in the country, with regional and local mutual insurance companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. More than 200,000 people are employed by NAMIC members.

NAMIC agrees that American insurers should be positioned to compete in the international insurance market. We support communication and coordination between international regulatory authorities. Working together will improve understanding of differing regulatory systems and may well result in shared best practices. The 2012 dialogue between the European Union (EU) and U.S. is an example and a foundation for such collaborative efforts.

We would, however, like to share some concerns with the committee about the state of international involvement in U.S regulation.

- It is our position that cooperation and coordination on the regulatory front is a positive thing, but should not result in abdication of regulatory authority to foreign jurisdictions or quasi-governmental bodies.
- Too much focus on regulatory equivalence with other nations could result in significant and costly changes in the U.S. insurance regulatory system. Our system is strong and time-tested. Many of the international insurance regulatory principles have never been implemented, and yet they are being used to measure countries and find them insufficient.
- If these concerns are not addressed, the impact on not only U.S.-based international insurers, but also on those operating only domestically could be very significant and multi-faceted.

Cooperation and Coordination

International efforts to regulate large, multi-national insurers are evolving. The International Association of Insurance Supervisors (IAIS) develops international standards for insurance supervision, provides training to its members, fosters cooperation between insurance regulators, and creates a forum for dialogue between insurance regulators and regulators in other financial and international sectors. The U.S. has been actively engaged in the deliberations of the IAIS. Both the National

Association of Insurance Commissioners (NAIC) and the Federal Insurance Office (FIO) play significant roles at IAIS. State regulators and staff participate in the work of the IAIS on a variety of issues including international solvency supervision, accounting standards, and reinsurance regulation, among others. The Director of FIO chairs the Technical Committee of the IAIS. The IAIS has developed a set of Insurance Core Principles (ICPs) which lay out international insurance standards and best practices for regulators.

The IAIS has supported the use of supervisory colleges as a means for international regulators to convene and discuss a particular insurance group. We support the use of supervisory colleges and believe their use is largely consistent with the NAIC's lead state concept. In the U.S. the states hold periodic regulator-to-regulator conference calls to discuss issues related to a particular insurance group that operates in those states. Supervisory colleges provide the opportunity for that kind of enhanced information sharing and regulatory dialogue affording regulators superior knowledge of the group and regulatory and environmental pressures. Such forums are particularly beneficial when they incorporate dialogue between insurance group management and the most impacted supervisors.

It is NAMIC's position that the international coordination of insurance regulation should be centered on understanding the risks of the insurance group from the perspective of how the insurance group identifies and manages its risk. We believe this type of communication is the foundation on which international coordination of insurance regulation should be developed.

However, NAMIC remains concerned about the focus on equivalence and strict adherence to the ICPs.

Misplaced Focus on Regulatory Equivalence

The IAIS has become far too prescriptive and detailed in the development of ICPs and the Common Framework (ComFrame) for Internationally Active Insurance Groups (IAIGs). We are concerned that such concepts, if forced onto the U.S. regulatory system, could weaken both the system and its domestic insurance companies. The realities of the U.S. insurance market are not always the same as those in other countries or regions. For example:

- Most European countries do not regulate the price of insurance products, and insurance rate regulation is prevalent in the U.S.
- The U.S. legal environment differs significantly from most other countries in a number of respects.
- Our dual state-federal system of government and the independence of state regulation of insurance also differentiate us from many other countries.

These realities need to be considered and reconciled before the U.S. regulators adopt any policies designed to streamline international regulation. While a common financial

language and conceptual similarities between jurisdictions facilitate cooperation and communication between regulators in different jurisdictions, forced convergence is not the answer. For example, the EU has a directive called Solvency II which is in a consultation phase until the end of 2013. Thereafter the directive still needs to be adopted by EU countries. Although this solvency program is not even implemented in EU countries, the EU leadership is already assessing the "equivalency" of foreign insurance regulatory systems to this aspirational system. Essentially the EU is developing a grading process for other jurisdictions' insurance regulatory systems.

The U.S. approach to solvency focuses on: 1.) mitigation by restricting company activities; 2.) disclosure and examination to avoid company insolvencies; and 3.) protection of the policyholders through guaranty funds that will make claim payments to customers of insolvent companies. Alternatively the European model is focused on capital requirements and risk assessments with the goal of *preventing all insolvencies*. The fundamental differences in the two philosophies are incorporated in the laws and regulations, making it difficult to achieve convergence or determine equivalency. This creates a serious concern. If the U.S. were not deemed equivalent, U.S. insurers seeking to do business in the EU would be subject to onerous additional requirements. This Solvency II equivalency structure gives one jurisdiction (the EU) significant power over the regulatory structure in countries around the world. NAMIC believes that the current U.S. system should be deemed equivalent as is, and changes should not be forced on domestic regulators simply due to equivalence considerations.

We appreciate that both the U.S. regulators at the NAIC and the FIO recognize the uniqueness of our system and recognize that changes should only be made when they will fit the U.S. insurance market. We urge the Committee to support these entities in their efforts to discuss and understand both systems, but to support strong and functional regulatory systems even with differences.

Potential Industry Impacts

International pressures to develop consistent financial policies can have unintended consequences.

Industry Consolidation. One of the quandaries of the financial crisis is that the scope and depth of the crisis was related to the significant size of the companies impacted – those companies considered "too big to fail." However, the "solutions" developed by regulators and law makers worldwide are to enhance regulation/oversight, converge accounting systems, and increase capital requirements. These solutions will not strengthen the <u>small</u> companies doing business around the world. These ideas and the compliance costs related to them will promote consolidation of the industries impacted. While some effort has been made to focus enhanced prudential standards on larger organizations, there is significant impact on small insurance companies. We have concerns about moving forward with significant regulatory change without considering the further consolidation of the insurance market and the impact on financial consolidation in the United States.

Impact on Small Companies. NAMIC is comprised of many members that are very small businesses. The diversity of insurance company size and scope in America is one of our market's great strengths. The U.S. has a great appreciation for small businesses and understands that by fostering small companies that we will grow our economy. Many of the initiatives underway internationally would result in significant increases in expense and complexity at the operating unit level. Even in the EU there is discussion around the impact that the new requirements could have on small, and especially small mutual, insurance companies. The increase in compliance costs will drive many of these companies to close their doors. Small companies typically serve particular segments of the market, often small communities or groups of customers that would be underserved in their absence.

Impact on U.S. Internationally Active Insurance Groups. The IAIS efforts include the development of ComFrame for internationally active insurance groups. The system has not yet been finalized, but there are already plans to field test ComFrame in 2014. It is a significant change in the regulation of IAIGs, and we urge movement in multi-year phases that will allow identification of the possible repercussions before implementing the entire proposal. The system will include enhanced capital requirements for these insurers that could result in further tightening of the market instead of an increase in economic activity. The impact on the insurance market and world economy will need to be evaluated as the changes are made.

Cost to the World Economy. There are many moving parts to the changes underway internationally. There is work toward converging accounting systems, enhanced capital requirements, and revised investment restrictions. There are new equivalence issues; new enterprise risk management requirements, new group supervision regulation, and new reinsurance standards and many other changes too numerous to list. The financial crisis provided a serious warning that something needed to be done to repair the weaknesses in the financial regulatory system. We need to identify those weaknesses and correct them, but we need to do so with an understanding of the impact of each correction and careful communication between the entities making those changes to ensure that we are not creating a bigger problem than we set out to solve.

Conclusion

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. We encourage enhanced and focused coordination and communication between insurance regulators worldwide to increase understanding and improve oversight of the insurance companies they regulate. NAMIC encourages acceptance of the differences in effective regulatory systems and suggests that consistency for its own sake does not serve a valuable purpose. Finally, we urge attention to the unintended and tangential impacts of the enhanced regulatory structure both internationally and in the U.S.