

Testimony of the  
National Association of Insurance Commissioners

Before the  
Subcommittee on Oversight & Investigations  
Committee on Financial Services  
United States House of Representatives

Regarding:  
“Oversight of the Financial Stability Oversight Council”

Thursday, April 14, 2011

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## **Introduction**

Chairman Neugebauer, Ranking Member Capuano, and Members of the Subcommittee, thank you for the opportunity to testify today. My name is John Huff, and I am Director of the Department of Insurance, Financial Institutions and Professional Registration for the State of Missouri. I serve as a non-voting member of the Financial Stability Oversight Council (FSOC). I am also a member of the National Association of Insurance Commissioners (NAIC), and I am testifying on behalf of that organization today. Specifically, I am here to discuss the experiences of our nation's 56 insurance regulators in working, through the NAIC, with FSOC. I would also like to address the unnecessary limitations that have been placed on my ability as an FSOC member to use insurance regulatory resources and consult with my fellow regulators

As you are well aware, Title I, Subtitle A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 establishes the FSOC, a panel of 15 members (10 voting and five non-voting) who meet regularly in order to develop the system by which financial institutions are designated Systemically Important Financial Institutions (SIFIs)—narrow, but very important, authority. By statute, there are supposed to be three representatives of insurance on the Council: a voting member with insurance expertise; the non-voting director of the Federal Insurance Office (FIO); and a non-voting state insurance commissioner, to be designated through a selection process determined by the state insurance commissioners. I have been filling that final spot since my appointment through the NAIC on September 23 of last year.

There are three matters that I wish to address in my testimony today:

- *First*, insurance is a unique product, fundamentally different from banking and securities products. Its system of state-based regulation is well-suited to the needs of consumers and companies alike. FSOC must recognize and acknowledge these differences in fulfilling its mission to monitor systemic risk within the U.S. financial system.
- *Second*, in passing Dodd-Frank, Congress did not supplant the state-based system of insurance regulation, and intended that insurance regulators have thorough representation on FSOC in order to ensure that the unique characteristics of that system could be brought to

bear on any decisions relating to FSOC's narrow mission of monitoring systemic risk and designating systemically important financial institutions for heightened supervision.

- *Finally*, the interests of insurance, and specifically insurance regulators, remain inadequately represented on FSOC; a problem that will continue for the foreseeable future.

### **Insurance as a Unique Product**

Again, insurance products are fundamentally different from banking products and securities instruments. While banking and securities products are typically bought pursuant to a consumer's interest in gaining revenue, the purchase of insurance is often necessary for personal financial protection and to provide economic stability. Insurance policies involve up front payment in exchange for a legal promise to pay benefits upon a specified loss-triggering event in the future. Bank products involve money deposited by customers and are subject to withdrawal on demand, which the bank is liable for at any time. As such, unlike bank products, most insurance products are not subject to the risk of runs. For those asset management products that could be subject to some level of run risk, mitigating factors exist such as policy loan limitations, surrender/withdrawal penalties and additional taxes. Additionally, unlike banks, insurers typically maintain a diverse product mix, so only a portion of the company's products would be subject to the already reduced level of run risk. U.S. insurance companies are also subject to significant regulatory oversight including stringent capital requirements, limits on the nature and extent of their investments, and quarterly analysis and periodic examinations.

For these reasons, it is the view of the NAIC that traditional insurance products and activities do not typically create systemic risk. However, connections with other financial activities may expose some insurers to the impact of systemic risk, and certain products may provide a conduit for systemic risk. Insurers may also have exposure to systemic risk as part of large conglomerates, but stringent solvency requirements at the insurer level help to minimize the impact of that risk. Insurers are subject to robust regulation for solvency and investment activities, and have proven their resilience throughout the recent financial crisis. It is also important to remember the effectiveness of the regulators' ability to ring fence the insurers to protect policyholder assets. The longer term nature of insurance products makes this a much

more effective tool for insurers than banks or other entities, and enables regulators to wind down troubled insurers in an orderly manner.

The insurance market in the U.S. is truly unique in the world. In aggregate premium dollar numbers, the U.S. market is number one on a list of the largest jurisdictions in the world based on 2009 data – and actually larger than those ranked second through sixth combined. However, it is also true that much of the U.S. market is quite localized. There are far more firms writing insurance in the U.S. than in any other economy, and while there are some dominant firms and some concentration in niche product lines, overall market concentration is less pronounced than in most other sectors. In the context of FSOC’s mission and systemic risk, this is important as competitors are more able to absorb company failures or disruptions in the marketplace.

There is also a wide variation in market size and complexity across the states. Three individual U.S. states rank in the top 10 jurisdictions worldwide as to premium volume, and nine states rank in the top 25. This variation in size and complexity, while not necessarily amenable to a one-size-fits-all approach to regulation, has allowed the U.S. state-based system of regulation to develop and implement best practice tools for a wide variety of insurance firms appropriate for their position in the market. This unique market structure has led to the evolution of a tailored system of regulatory oversight and supervision.

The current nationally coordinated state-based system of insurance regulation has been successfully providing sound, cooperative regulation and policyholder protections for 140 years and utilizes multiple sets of eyes and rigorous peer reviews to maximize regulatory scrutiny of insurers. A distinguishing aspect of the state-based insurance regulatory system is its collaborative culture. Working through the NAIC committee structure and processes, states have developed a system of insurance regulation that respects varying geographic and demographic considerations while requiring uniform financial reporting and uniform application of risk-based capital solvency oversight to guarantee that policyholders’ funds are available when needed. All 50 states are currently accredited by the NAIC, which means they have had their financial regulatory frameworks and monitoring programs reviewed by independent teams and certified to meet certain baseline measures in order to ensure that jurisdictions can have confidence in other

states' financial oversight. This oversight includes: solvency regulation; rate and form regulation; market conduct examinations; monitoring competition and statistical reporting; residual market administration; consumer information and services; producer licensing; and anti-fraud protection.

Information sharing among regulators is a fundamental benefit of the insurance regulatory community that gathers as the NAIC. Through the NAIC committee structure, regulators are able to consult with each other, share regulatory information and approaches, and develop effective regulatory policies in the U.S. By way of example, in the past year, through the NAIC and its committee system, insurance regulators have made important changes to the Model Holding Company Act and Regulation that will provide regulators a clearer view of the operations of financial groups and their impact on any insurers within those groups. Regulators have enhanced the required securities lending disclosures, requiring additional transparency in an area that received attention during the financial crisis. They have also reduced regulatory reliance on credit ratings issued by the Nationally Recognized Statistical Rating Organizations by changing how commercial mortgage backed securities and residential mortgage backed securities are valued for determining risk based capital requirements.

It is also through the NAIC and its committee structure that insurance regulators work with international insurance regulators. Significantly, the NAIC is a founding member of the International Association of Insurance Supervisors (IAIS), which represents insurance regulators and supervisors of 190 jurisdictions in nearly 140 countries. Its goals are to promote effective and globally consistent supervision of the insurance industry and to contribute to global financial stability. It is at the IAIS Financial Stability Committee (where the NAIC and state insurance regulators have been quite active) that approaches are initially being developed to evaluate specific insurers and determine whether such entities will be considered Global Systemically Important Financial Institutions (GSIFIs).

### **Congressional Intent**

As federal regulators and Members of Congress were negotiating the Dodd-Frank Act last year, the NAIC's overarching message to the authors was that "one size does not fit all." Insurance is

a different product and is regulated in a different manner than other financial products. Traditional insurance activities were not the sources of the systemic risk that enveloped our financial system in 2007 and 2008. Furthermore, insurance regulators already had well-developed systems for rehabilitating and, if necessary, unwinding troubled insurance companies while keeping policyholders whole.

Congress recognized these important differences in the Dodd-Frank Act. Insurance products do not fall under the jurisdiction of the Consumer Financial Protection Bureau. There are different circumstances under which insurance companies can be declared systemically risky and in need of winding down – and such activity would take place pursuant to state law.

In determining how insurance would be represented on the FSOC, Congress recognized that federal regulators may not fully understand these products and the ways in which these products have been, and will continue to be, successfully regulated by the states. As such, they ensured that three insurance experts would be placed on FSOC: an insurance expert appointed by the President and confirmed by the Senate; a state insurance commissioner; and the Director of FIO.

In regards to the selection of the state insurance commissioner designee to the Council, the Dodd-Frank Act mandates that a non-voting insurance regulator is to be appointed to FSOC through a process determined by all of the insurance regulators. In doing so, they recognized that the state insurance regulators, through the NAIC, have their own processes for making policy and choosing their representatives, and the drafters of Dodd-Frank deferred to those processes as a matter of law. In crafting the provision in this manner, we believe Congress intended for my position to represent the interests of the state insurance regulatory system – not just the interests of one state. At our most recent NAIC National Meeting, two former staff to the House Financial Services Committee deeply involved in drafting Dodd Frank– one a Democrat, and one a Republican – indicated that this was their understanding of Congressional intent as well.

The important role that Congress intended for state insurance regulators to play is further buttressed by Section 111(d) of the Dodd-Frank Act, which states:

“The Council may appoint such special advisory, technical, or professional committees as may be useful in carrying out the functions of the Council, including an advisory committee consisting of State regulators, and the members of such committees may be members of the Council, or other persons, or both.”

Similar language was included in FSOC’s own bylaws, which are posted on the U.S. Treasury Department’s website.

The authors of Dodd-Frank recognized the unique nature of insurance products. As such, they included language authorizing FSOC to consult with other state regulators in order to ensure that the Council has access to all available resources and expertise it needs to fully understand the insurance business model and insurance regulation.

### **Inadequate Insurance Expertise on FSOC**

In the nearly nine months since FSOC began its official operations, the Council has been working at a furious pace. The Integrated Implementation Roadmap, the minutes of FSOC meetings, the proposed rules and studies available to the public on the FSOC website, and testimony here today from my colleagues on this panel can give you a good idea of the volume of work and progress that the council is making. But while FSOC engages in work that could impact insurers, two of our three insurance representatives are absent from the table, and I have been prohibited from utilizing available state regulatory resources, including engaging other state regulators, some of whom are active in very similar work in the international arena. Moreover, no advisory committees of state regulators have been established.

In the time since my appointment to the FSOC, I personally have attended four full FSOC meetings and, along with my very limited staff resources, have participated in innumerable meetings and conference calls of FSOC’s nine committees. Unfortunately, my seat at the table is the only one having to do with insurance that has been filled. While my colleague, Illinois Insurance Director Michael McRaith, recently accepted an appointment to be the first Director of FIO, he will not begin his new job – and term on the Council – until June. While the new FIO

will serve as a source of information on insurance for federal entities, and help negotiate international agreements, the Dodd-Frank Act makes clear that FIO will not have any general supervisory or regulatory authority over the business of insurance and extremely narrow preemptive ability. Meanwhile, President Obama has yet to nominate the one voting member with insurance expertise to fill the third spot on the Council.

Making matters far worse, I have been restricted from consulting with my fellow insurance regulators on matters before FSOC, even though our regulatory system requires regulators to work collaboratively and share information with one another in confidential settings. The U.S. Treasury Department has taken a very narrow and, in my opinion and the NAIC's opinion, incorrect view of the authorizing language in Title I, Subtitle A of the Dodd-Frank Act by claiming that I represent the state of Missouri and not the insurance regulatory system. Such a position contradicts Congressional intent and the deference accorded to state insurance regulators in the explicit language of the statute itself. But most importantly, it contradicts logic and reason. Quite simply, FSOC should want – and the U.S. taxpayers should demand – all the regulatory resources and expertise that their regulators can provide to FSOC's important work in protecting the U.S. financial system. From the beginning, the state insurance regulators and the NAIC have been and continue to be willing to contribute to FSOC's important work relating to insurance.

After repeated requests to consult with regulators in other states and bring on additional staff resources, and after months of internal discussions with the U.S. Treasury Department on how we might be able to leverage the extensive state insurance regulatory resources potentially at my disposal, the NAIC officers, our C.E.O., Dr. Terri Vaughan, and I took a step we had initially hoped could be avoided, and sent a public letter to Treasury Secretary Geithner asking for him to rectify this issue. We have yet to receive a written reply.

While we have made limited progress with the U.S. Treasury Department on this issue in recent weeks, I am frustrated that it took six months, and repeated inquiries from both the NAIC and Congress, in order for the U.S. Treasury Department to listen to our concerns. Even then, while I appreciate the accommodations made to date, they are simply not sufficient in light of the very



important work FSOC is engaged in. I am concerned that if progress on this front continues to be made at a similarly slow pace moving forward, decisions that will impact insurance companies, insurance consumers, and the financial stability of the U.S. will be made without adequate advice and counsel from those individuals who know insurance companies best and how such companies are already regulated.

Thank you again for the opportunity to testify before you today. I am happy to answer your questions.