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Prepared remarks of Senator Ben Nelson, NAIC CEO

Challenges of US economy in the aftermath of the global financial crisis and its wider effects

The 2008 financial crisis continues to have a ripple effect in the US. It has reshaped financial regulation and policy in a significant way, and more importantly, its effects continue to be felt by the real economy. Businesses and individuals' attitude toward the financial sector, toward banking, toward investment, toward housing, and toward risk have been fundamentally changed.

I think it's fair to say that people don't link the last crisis with the insurance sector, outside of the vague notion that AIG was an insurer of some kind, but there's no question that all financial institutions including insurers are being looked at from a new, more skeptical perspective by customers, regulators, and public policy makers alike. I'll talk a little about the regulatory response to this new reality in a minute, but I should first mention what is the current economic climate in the US as it relates to insurance.

Not surprisingly, low interest rates continue to plague the life insurance sector, and increasingly costly and devastating natural catastrophes continue to challenge the property/casualty sector. There continues to be periodic self-inflicted anxiety coming not from Wall Street, but Washington, as we debate the budget, monetary policy, and the overall role of government in our lives.

But there are reasons for optimism – at least if you’re watching your stock portfolio. U.S. equity markets are performing well. Housing is starting to recover as a decline in inventory has put upward pressure on pricing, at least in some markets. The stubborn US unemployment rate has improved. And the financial sector is stable, and more importantly, better prepared to weather the next crisis. US insurers remain strong, profitable, and competitive.

All these signs are reason to breathe a sigh of relief, but we cannot take our focus off the work that needs to be done. The best time to inspect and strengthen your sea walls is when the tide is on its way out, not when it’s rising.

Response to the Crisis in the US – Focused on Banks and Not Insurers

As a US Senator, I had a ring-side seat to the public policy and regulatory response to the last crisis, and I hope to be enjoying retirement by the time the next one hits! The Dodd Frank Act, which I ultimately voted for, put in place sweeping changes to US financial regulation, but little of it was aimed at the insurance sector. There was broad understanding that the problems at AIG were not the result of the traditional insurance business or insurance regulation. Beyond AIG, any issues in the insurance sector paled in comparison to the failures occurring in the banking sector.

Nevertheless, there are elements of Dodd Frank that impact insurers and insurance regulation – particularly in those areas where insurance intersects with banking and the capital markets. The Dodd Frank Act addressed these limited instances with expanded consolidated supervision. This supervision was already in place, at least in theory, by the Office of Thrift Supervision – but this power has now been transferred to the Federal Reserve with some additional powers.

Dodd Frank also deals with any company that could threaten the financial system and the economy, including any insurers unfortunate enough to meet that description. We don't think a company engaged in traditional insurance business is likely to merit such distinction, but there are other activities and factors that could result in increased scrutiny by the Financial Stability Oversight Council. While insurance didn't cause the U.S. crisis, Congress was thoughtful in considering insurance to ensure that reforms didn't undermine the system of state regulation which clearly demonstrated it was up the task.

Insurance Didn't Cause the Crisis – But We're Not Standing Still

Regardless of efforts at the federal level, the states have no intention of standing still. We are working to ensure our regulatory system continues to evolve and ensure stable and competitive markets while protecting consumers. We are working to put in place improvements to insurance group supervision and require more information about the entire enterprise – not just the insurance companies. We are leading or participating in numerous supervisory colleges with our U.S. and foreign colleagues. This type of collaboration, with multiple eyes on a problem, is a core strength of our own state-based system.

We are also working to transition life insurance reserving from a formulaic approach to a principles-based approach. This will allow companies to right-size their reserves for their specific risk profile, while ensuring that companies remain strong and ready to meet their promises to policyholders, even in times of stress.

We are working to reduce reinsurance collateral – you may have heard a little something about this issue – and while I'm sure there are those in the room who would prefer a different approach or a complete abandonment of collateral, we believe the approach we're pursuing is right for our market and our policyholders.

International Collaboration and Involvement is a State Regulatory Obligation

Beyond regulatory tools and requirements, we think dialog and collaboration with other regulators is critical – particularly at the international level. We are a founding member of the IAIS and will continue to be active in all its developments. Increasingly, international principles and standards are influencing domestic regulatory policy. This has the potential for a real world impact on our companies and consumers. With that in mind, we have not just an opportunity, but an obligation, to be at the table and influencing these developments.

As we provide input to IAIS developments, we have to be mindful of our regulatory structure at home. In the U.S., we have functional regulation with some areas of consolidated supervision. There are clear lanes of traffic that have evolved over the years that must be respected. For example, in areas where we discuss group supervision, in the U.S. this will require us to interact with and collaborate with our banking and securities regulator colleagues. And if the company is of a certain size and structure, we must also consider the impact on the Federal Reserve's consolidated authority.

This brings me to an important discussion taking place at the IAIS, about whether to pursue creation of a global capital standard for insurance. Our fear is that this focus puts an overreliance on capital as the answer to all of life's problems. More capital would not have saved AIG. And given the different accounting systems and legal structures around the globe, it would be extremely difficult to develop such a standard without major changes to regulatory structures, at least in the U.S., that go well beyond just insurance regulation.

Aside from the complexities of creating a global capital standard, we have yet to see compelling evidence that answers an all-too-often ignored question: WHY? Why do we need such a standard? What problem will it solve? Will it prevent the next crisis if it did little to

prevent the last one? Until we have broader understanding and consensus on these threshold questions, we should focus our energies on what is possible and necessary now. For example, we should be ramping up our efforts in supervisory colleges to use the authorities we already have to better understand internationally active insurance groups. We should collect information from insurers that illustrate a picture of all risks, not just those from the insurance operations. And we should make sure we have in place mechanisms to analyze this data and have the ability to share it confidentiality within the regulatory community.

There is much that we can do to enhance regulation and improve stability without broad new mandates. Our focus at the IAIS is to collaborate on what is possible and useful and avoid falling into the trap of confusing process with progress.

Wrapping Up

In the U.S. there is obviously a tremendous amount of activity underway in the states, at the federal level, and internationally that impact insurance companies, consumers, and regulators. The NAIC is actively involved at all levels to provide input on behalf of US insurance regulators, and we have systems in place to gather input and feedback from companies and consumers alike.

The crisis dealt a significant blow to our financial systems and our economies, but perhaps it was the wake-up call we needed. I have never seen regulators on both sides of the Atlantic more focused and more collaborative than they are right now. Depending on where you sit, that can be a good or a bad thing, but I'm an optimist – so I'm looking forward to the work ahead.