

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Insurance, Housing and
Community Opportunity
Committee on Financial Services
United States House of Representatives

Regarding:

U.S. Insurance Sector: International Competitiveness and Jobs

May 17, 2012

Kevin M. McCarty
Commissioner, Florida Office of Insurance Regulation
and
President of the National Association of Insurance Commissioners

Introduction

Chairman Biggert, Ranking Member Gutierrez, and members of the Subcommittee, thank you for the opportunity to testify today. My name is Kevin McCarty, and I am the Commissioner of Insurance for the State of Florida. I am here as President of the National Association of Insurance Commissioners (NAIC), and I present this testimony on behalf of that organization. The NAIC is the United States standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, we establish standards and best practices, conduct peer review, and coordinate our regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

Insurance markets have evolved over the years to become increasingly global, interconnected, and convergent – a trend that will undoubtedly continue in years to come. Insurance regulators are heavily invested in the future of insurance globally, and the NAIC is committed to coordinating with our regulator colleagues, both domestically and internationally, to ensure open, competitive, stable markets around the world. In this regard, the most important thing we can do is to promote a level playing field across the globe through strong regulatory systems while recognizing that there will continue to be different cultural, legal, and operational differences in regulatory regimes around the world. Our state-based system in the U.S. has a strong track record of evolving to meet the challenges posed by dynamic markets, and we continue to believe that well-regulated markets both here and abroad make for well-protected policyholders.

Today, I will provide the Committee with an overview of the NAIC's involvement in recent international discussions and key international regulatory developments that promote well-regulated markets abroad and protect policyholder interests. Specifically, I would like to focus my comments on three major areas: 1) international regulatory standard-setting, 2) trade and economic development, and 3) enhancement of coordination and communication among international insurance regulators.

International Regulatory Standard-Setting

Insurance is critical to the U.S. economy and plays an equally important role in global markets. The United States is the world's largest national insurance market, with more than one-third of the total global market share. In fact, the U.S. had more insurance business written within its borders than countries ranked 2 to 6 combined in 2010, and many of our states are home to more insurance activity than most countries around the world. Six of our states rank in the top 20 leading markets in direct written premium alone.

Our market leadership, however, is not based only on market share or premium dollar amount. We believe U.S. state insurance regulators provide leadership in the international regulatory community by setting strong standards, developing creative solutions to new and existing regulatory challenges, and consistently seeking to increase transparency and understanding in our efforts to protect policyholders' interests.

In this regard, we are pleased to work hand in hand with the Federal Insurance Office (FIO) in many of these international initiatives. FIO has an important role to play as a representative of the federal government in such discussions, and we are working hard to build a constructive partnership. While we expect the FIO to increase its level of engagement with the international regulatory community, the fact remains that state regulators have ultimate responsibility for implementing any new international standards. It is therefore critical that any international discussions and agreements relating to regulatory prerogatives continue to be made with the full participation and agreement of U.S. insurance regulators.

IAIS Initiatives

The NAIC was a founding member of the International Association of Insurance Supervisors, the IAIS, for short. Established in 1994, the IAIS has a membership that includes insurance regulators and supervisors from over 190 jurisdictions in 140 countries. Additionally, more than 120 organizations and individuals participate to some degree in the activities of the IAIS as Observers.

The IAIS is led by an Executive Committee, which has three representatives from the United States, including Dr. Terri Vaughan, the NAIC's Chief Executive Officer, Michael McRaith, the

Director of the FIO, and myself as President of the NAIC. Additionally, U.S. insurance regulators and NAIC staff are active participants in almost all of the twenty working parties of the IAIS, serving as the Chair of the Solvency Subcommittee, and the Vice Chairs of three other working parties: the Financial Stability Committee, the Supervisory Forum, and the Standards Observance Subcommittee. Our active participation and leadership roles in these various working parties continues to ensure that the national system of state-based insurance regulation in the U.S. has a prominent voice in the international arena as we discuss global insurance principles and standards.

The NAIC is devoting significant resources and energy to international standard setting through involvement at the IAIS and other international bodies such as the Organization for Economic Cooperation and Development (OECD). We were integral to the development of updated IAIS Insurance Core Principles (ICPs), approved last October, which provides the basis for the International Monetary Fund's insurance sector assessment in their Financial Sector Assessment Program (FSAP). The FSAP is designed to assess a particular jurisdiction's regulation of financial institutions. The last time the IMF assessed U.S. insurance regulation was in 2010, when the FSAP found that U.S. insurance regulators observed or largely observed 25 of the 28 IAIS ICPs. The IMF stated about the U.S. system: "There is generally a high level of observance of the Insurance Core Principles. Aspects of regulatory work such as data collection and analysis in relation to individual insurance companies are world leading. There are mechanisms to ensure individual states implement solvency requirements effectively."

The NAIC and state regulators are also active at the IAIS Financial Stability Committee, which is currently in the process of developing a methodology for identifying Globally Systemic Important Insurers (or G-SIFIs) at the request of the Financial Stability Board (FSB). As members of this Committee and with the NAIC as vice-chair, U.S. insurance regulators along with the FIO have extensive input into the ongoing IAIS process as the IAIS Financial Stability Committee works on this important issue.

In addition to participating and often leading these IAIS efforts, we especially look forward to hosting the IAIS annual conference here in Washington, DC, this October.

Joint Forum

The NAIC is also very active in the Joint Forum. Established in 1996 under the Basel Committee on Banking supervision, the International Organization of Securities Commissions, and the IAIS, the forum strives to deal with issues common to the banking, securities, and insurance sectors, including the regulation of financial conglomerates. The chairmanship of the Joint Forum rotates every two years among the standard setting bodies and in 2012, NAIC CEO Dr. Vaughan, was appointed Chair of the Joint Forum on behalf of the IAIS. Dr. Vaughan and her colleagues are focusing their efforts on enhanced communication between regulators, developing guidance and principles to encourage cross-sector consistency and reduce opportunities for arbitrage, and identifying duplication in work efforts. Current work of the Joint Forum includes studies on the cross-sectoral interactions of mortgage insurance, emerging longevity risk, and point-of-sale disclosures to consumers.

Financial Stability Board

The recent financial crisis has clearly demonstrated that it is not sufficient to focus on a single sector any longer, and we are increasingly being asked to participate in global dialogues with international supervisors and standard setters from across the financial spectrum. The FSB coordinates at the international level the work of international standard setting bodies and national financial authorities to address vulnerabilities affecting the global financial system and to develop and promote the implementation of effective supervisory and regulatory policies promoting financial stability.

The U.S., represented by the United States Treasury Department, Federal Reserve Board of Governors, and the Securities and Exchange Commission, is a member of the FSB, which is engaging directly with the IAIS on critical issues including the identification of G-SIFIs. The involvement of insurance regulators is essential as the FSB tends to have a bank-centric focus, but its decisions have an impact beyond the banking sector. Through the IAIS, we continue to stress that the insurance business model needs to be distinguished from the banking business model when discussing and applying any new regulatory requirements.

U.S. insurance regulators also continue to provide input to the FSB on systemic risk to ensure that the insurance sector perspective is appropriately represented at the FSB and that the FSB takes into account the differences among business models when promulgating any recommendations regarding the identification and appropriate regulation of non-bank SIFIs. I would encourage federal regulators and legislators alike to be mindful of both the scope and speed of the FSB's activity, and work to ensure that appropriate deference be provided to the regulatory authorities of member nations.

Economic Development and Trade

Next, I would like to focus on the insurance sector's critical role in promoting economic growth. In order to ensure that growth, we must maintain a level playing field here and abroad in order to create and protect jobs. There are a number of ways we as U.S. regulators are encouraging economic growth of the insurance sector for U.S. based insurers. We continue to promote a global regulatory approach based on fundamental, collective principles of solvency and consumer protection. We also continue to promote transparency and due process in international standard setting, which are critical to consumer confidence in insurance products, and should be primary considerations reflected in any recommended international standards.

State regulators are also keenly aware of the importance of international trade and trade agreements for economic development. As the Office of the United States Trade Representative (USTR) negotiates trade agreements such as the ongoing Trans-Pacific Partnership agreement and seeks improved market access for U.S. insurers, the NAIC provides technical expertise and advice. Our partnership with the USTR dates back to the early 1990s at a time when the North American Free Trade Agreement and World Trade Organization's – General Agreement on Trade in Services (GATS) were negotiated.

In providing expert regulator guidance to the USTR on technical provisions relating to insurance, state insurance regulators and the NAIC seek to ensure that agreements and policies under discussion will promote stable regulatory practices in other countries. We help our negotiators make the case that a liberalized market does not mean the weakening of regulatory standards by illustrating the openness of the U.S. market to foreign competition (over 20% of the U.S. insurance market is foreign controlled), yet we maintain an effective supervision of the market

place. We also illustrate to our trading partners the importance of insurance to our State economies and show the number of jobs the insurance sector supports back home and how insurance increases economic output. Furthermore, we discuss the role insurance plays in social policy through mitigating risk and protecting our citizens from the potentially devastating financial losses from floods or other natural disasters. The NAIC also plays a role in ensuring that the commitments that the U.S. undertakes in these agreements is consistent with existing State laws, and where necessary consult with the relevant States to effect changes that can eliminate unnecessary “reservations” to U.S. trade commitments.

In addition to such negotiations, the U.S. and a number of our trading partners hold annual insurance dialogues organized by the USTR, including China, Japan and recently Korea as part of their entry into force of the U.S.-Korea Free Trade Agreement. The NAIC serves as the representative for the regulators and participates in each of these dialogues, working side by side with our trade negotiators and providing guidance as they work to overcome remaining trade barriers. Ultimately, our role as technical advisors is to illustrate the benefits that our consumers have reaped from our open markets and also to ensure that USTR has the best technical advice on hand as they seek commitments from our trading partners during negotiations.

Through the NAIC’s International Insurance Relations (G) Committee we provide technical assistance to developing economies. Over the years we have developed memoranda of understanding with 13 foreign countries to provide this assistance and regulatory cooperation. Often at the request of these foreign regulators, we regularly send U.S. insurance regulators and NAIC staff to provide the technical training that these countries need. The goal of these pro-bono projects is to aid these countries as they develop their insurance markets into stable and vibrant markets where U.S. insurers may ultimately be able to provide services. We also seek to partner with multilateral development banks such as the World Bank and the Asia Development Bank to provide the training.

Last, the NAIC is represented on the Organization for Economic Cooperation and Development’s (OECD) Insurance and Private Pensions Committee by Pennsylvania Insurance Commissioner Michael Consedine. In that capacity, Commissioner Consedine attends OECD Committee and Subcommittee meetings and serves as the U.S. regulator expert on insurance, while sitting side by side with the Commerce & Treasury Departments. The NAIC drafts and

comments on insurance related papers, acts as the coordinating body in the completion of statistical questionnaires, and presents information about the U.S. system of insurance regulation.

Enhancing Communication and Coordination Among Regulators

Another area of focus I want to raise with you today is the importance of our improved information exchange and better coordination with our international regulatory counterparts. Through the NAIC we are redoubling efforts to strengthen supervision through enhanced coordination and better communication between regulators. State insurance supervisors are frequently involved in technical exchanges, training programs, and other forms of regular dialogue.

Our International Insurance Relations (G) Committee and International Regulatory Cooperation Working Group are tasked with strengthening international regulatory systems by interacting with international regulators, reviewing proposed laws and regulations for insurance supervisors in countries updating their regulatory structure and those with emerging economies, conducting educational seminars to provide an understanding of the U.S. system of regulation, and establishing fellowship opportunities between U.S. and foreign insurance regulators, among other things. The NAIC also launched its own Solvency Modernization Initiative (SMI) in 2008 as part of our continuous improvement process. As part of that initiative, we are examining international developments regarding insurance supervision, banking supervision, and international accounting standards, and will consider potential applications for U.S. insurance regulation.

ComFrame and Supervisory Forum

One key initiative NAIC members and staff are working on is the development of a Common Framework or “ComFrame” for the Supervision of Internationally Active Insurance Groups, or IAIGs. This project, conducted through the IAIS, aims to make group-wide supervision of IAIGs more effective, foster cooperation and coordination among supervisors around the world and to close regulatory gaps. The ultimate role of ComFrame is still under discussion and will continue to develop; however, the intent is given by its name – a common framework – one that lays out how supervisors around the globe can work together to supervise internationally active insurance groups. ComFrame should not be an additional layer of prescriptive requirements, but rather a

framework that regulators from around the globe can use to effectively supervise large global firms, despite the differences that will remain between each of our respective regulatory systems. If done right, ComFrame has the potential to create a multi-jurisdictional approach to supervision that emphasizes robust oversight and cooperation while maintaining the proper balance between different jurisdictions.

U.S. regulators are also actively involved in the development of the Supervisory Forum at the IAIS. That Forum aims to strengthen the effectiveness of insurance supervision and to foster convergence of supervisory practices through the exchange of real-world experiences and the expertise of front-line, senior regulators from around the globe. The concept of the Forum stemmed from a U.S. proposal based on the U.S. multi-jurisdictional approach, utilizing discussions similar to those that occur at the NAIC's Financial Analysis Working Group (FAWG).

US-EU Dialogue

Another critical area in the international insurance regulatory arena that continues to grow in importance is the work done to harmonize regulatory approaches and foster regulator trust and mutual understanding. We must remember that the focus of regulatory convergence should be the arrival at common outcomes, and not necessarily universal requirements or structures. As we continue to work with our international counterparts, U.S. regulators cannot abdicate our responsibility to consider the impact of regulatory convergence on U.S. insurance consumers and companies. We have an obligation to engage with our foreign counterparts, along with the FIO and USTR, to ensure that differences in regulation between jurisdictions do not become an unnecessary barrier to transatlantic trade, while preserving the elements of our system that provide a stable and competitive market.

A prime example of our work in this area is the NAIC-EU regulatory dialogue. The NAIC has had ongoing dialogues with the EU for over 10 years on various topical issues of mutual regulatory concern. These recurring dialogues have been critical to enhancing supervisory understanding, cooperation and coordination between our respective jurisdictions and have established the basis on which to build new cooperation projects. A new US-EU joint project, led by a steering committee of key U.S. and EU government representatives, is guiding the

priorities of 7 technical work streams to identify areas of alignment and differences between the two regulatory systems. The U.S. representatives to this steering committee are myself, NAIC CEO Dr. Terri Vaughan, and the Director of the Federal Insurance Office, Michael McRaith. Each of the technical work streams have representatives from the States, NAIC, FIO and the EU, and we believe this process provides us with an opportunity to work collaboratively with our EU counterparts and FIO in a constructive manner to develop an even better mutual understanding of our respective systems. Through these processes, regulators develop a trust in our respective systems while laying the groundwork for increasing convergence in the future, consistent with the IAIS standards. We continue to demonstrate that the U.S. has a strong system of insurance solvency supervision that helped the world's largest insurance market weather the worst financial crisis in decades.

Just last month, several U.S. regulators and I participated in a week of US-EU events including an NAIC-EU regulator-to-regulator dialogue in Washington. Topics we discussed included international standards development including ComFrame, supervisory cooperation, and issues of mutual concern related to global financial stability. We also discussed domestic regulatory developments and market trends in our respective jurisdictions. As I noted, these kinds of exchanges and dialogues are critical to successfully improving insurance regulation everywhere. Other issues that we continually discuss with our colleagues from Europe and around the world include best practices, transparency and due process, cross-border insurance services, and regulatory harmonization. The more robust dialogue and mutual understanding we can create, the better our regulatory communities will be equipped to face challenges that arise.

International Fellows Program

Building on the success of our China Intern-Pilot Program in 2004, the NAIC developed a formal International Internship Program in 2005 to advance working relations with foreign markets, emphasizing the exchange of regulatory techniques and technology. The program was formally renamed the International Fellows Program in 2010. The Fellows participate in a week-long orientation program at NAIC offices in Kansas City, Missouri, focusing on the broad principles of insurance regulation in the United States. Each Fellow then travels to a different state for five weeks, working in technical areas of their specialization under the supervision of a state

insurance department staff member, who serves as a mentor and host. Over 168 fellows from around the globe have participated in this training program since its inception in 2004.

Conclusion

In light of the 2008 global financial crisis and subsequent developments, the insurer business model is evolving. We at the NAIC, along with our fellow regulators around the world, must also evolve and improve the way we supervise our markets. We must continue our ongoing efforts to develop better structures and tools to help us anticipate risk, some of which may evolve beyond our borders.

Beyond all the formal structures and tools we discuss today, increased regulatory collaboration ultimately hinges on fostering trust and relationships between supervisors in order to ensure we will all be successful in the very challenging tasks we face. As I mentioned earlier, well-regulated markets and competitive markets are not mutually exclusive, and both are necessary to provide policyholders with the choice and stability they expect from their insurers. At the NAIC we will continue to coordinate with FIO, the USTR, industry, and our international colleagues to develop the types of regulatory schemes that promote **open, competitive, stable, and well-regulated markets around the world**. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions today.