

WILLIAMS & JENSEN, PLLC

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Re: Treasury Conference on “Insurance Regulation in the United States: Modernization and Improvement”

Dt: December 9, 2011

On December 9, the U.S. Treasury Department held a [conference](#) on “Insurance Regulation in the United States: Modernization and Improvement.” The conference focused on the Federal Insurance Office (FIO), consumer protection concerns for insurance, areas for insurance regulatory reform, international developments in insurance, and prudential standards for insurance.

Opening Remarks

[Deputy Secretary Neal Wolin](#) (Treasury) stated that the Treasury Department has begun to “stand up” the Federal Insurance Office (FIO). He noted the importance of insurance in the “smooth and efficient operation of the economy,” and that insurance accounts for 8% GDP and the insurance industry employs 2% of the U.S. workforce. He noted that before the Dodd-Frank Act (DFA) there was no centralized repository for insurance expertise, so through the FIO federal coordination is possible. **Deputy Secretary Wolin** stated that the FIO has begun to fulfill its mandates under DFA to monitor the insurance industry, identify gaps in regulation, work with the Financial Stability Oversight Council (FSOC), and ensure the stability of the insurance industry. Additionally, he noted that the FIO is responsible for international development and coordination, helping develop insurance products for low income consumers, and advising regulators on insurance issues. He identified the importance of state regulation for insurance and stated that state regulators are an important partner with FIO, but he emphasized that regulating insurance is a state responsibility rather than a FIO responsibility. He stated that a strong relation with the state regulators is important for FIO to achieve its goals. He explained that FIO has already begun work on the study and report required under the DFA and has posted a notice in the *Federal Register* which includes a series of questions FIO is seeking comment on. **Deputy Secretary Wolin** also noted that the FIO has assisted FSOC on their rulemakings and studies. He stated that the Federal Advisory Committee on Insurance (FACI) has been established with 15 insurance experts as members and the FIO has become a full member in the International Association of Insurance Supervisors (IAIS) which has been working on a framework for international regulatory matters. He explained that the FIO is scheduled to report to Congress in January on how to improve insurance regulation and has been reaching out to industry for input.

Panel One: Consumer Protection and the Business of Insurance

Moderator:

Mark Thresher – Chief Financial Officer, Nationwide

Panelists:

Daniel Schwarcz – University of Minnesota Law School

John Hill – CEO, Magna Carta Companies

Markham McKnight – President, Bancorp South

Johnny Johns – CEO, Protective Life

J. Robert Hunter – Director of Insurance at the Consumer Federation of America

Discussion

Daniel Schwarcz (University of Minnesota Law School) spoke about the failings of the “prescriptive approach” of the state-based insurance regulation system. He stated that this prescriptive approach loses transparency, and does not provide the consumer with information about the differences between different insurance providers and their products. He claimed that detailed and important information about different insurers’ policies is often completely unavailable, putting the consumer at a disadvantage. **Schwarcz** also noted that under the current system, a consumer cannot be certain how likely it is for a claim to be paid, or how quickly a claim will be paid. He argued that an informed market is the most important regulator, and that consumers currently rely too heavily on regulation. In order to improve transparency, **Schwarcz** advocated for effective summary disclosure by experts, full availability of information so that insurance intermediaries can keep individuals informed, and intermediaries who act in the best interest of individuals. He acknowledged that transparency is complicated and difficult to achieve, but noted it is needed in the insurance industry.

John Hill (Magna Carta Companies) stated that consumer protection should be the top priority of the insurance industry. He argued that solvency is the ultimate consumer protection, and that it is crucial to ensure that insurance companies survive and thrive. He voiced his support for the state-based system. **Hill** noted that the insurance industry (particularly property and casualty insurance) did relatively well during the financial crisis of 2008. He also stated that solvency oversight and consumer protection are the hallmark of the state-based system. **Hill** stressed the need to streamline state processes and to eliminate burdensome and duplicative regulations that impact the affordability of insurance policies. He spoke against foreign regulation of domestic insurance markets. **Hill** stated that the FIO can act as a “bully pulpit” for suggesting key changes to the insurance industry. He advocated for the FIO communicating with other federal offices regarding new policies in order to prevent unintended negative consequences. He argued that the best way to ensure consumer protection is to provide certainty through a regulatory system that limits cost but is effective.

Markham McKnight (Bancorp South) expressed his concern over the lack of uniformity and reciprocity in the state-based system. He spoke in favor of the creation of a national registry in order to ensure uniformity and reciprocity in the insurance industry. **McKnight** spoke in favor of the FIO taking a lead on improving surplus lines and producer licensing.

Johnny Johns (Protective Life) noted that individual life insurance policies are at their lowest rate in 50 years, with less than 50% of individuals holding a policy. He spoke about an ongoing retirement crisis, with the average American only having enough retirement savings to last 18 months. **Johns** also noted that the market cap of private life insurers is half of what it was 6 years ago. He explained that Americans want life insurance, that insurers have capacity, but that the problem stems from a general distrust of insurers, concern over the complexity of products, and barriers to distribution. **Johns** applauded the state-based system for being effective in prudential solvency regulation and consumer regulation. He claimed that the current insurance regulatory system is inefficient and does not fit into the modern international framework for regulation.

J. Robert Hunter (Consumer Federation of America) noted that the state-based system has been successful in maintaining the solvency of the insurance industry, but has struggled with issues of transparency and market conduct. He stated that while he is against inefficient regulation for the insurance industry, he cautioned against lowering regulatory standards simply for the sake of

efficiency. He encouraged the FIO to study the regulation of credit-related insurance to see if it falls into the cracks between state and federal regulation. He also claimed that most states fail to protect low and middle income (LMI) individuals seeking auto insurance. He explained that 30% of LMI Americans are driving without auto insurance due to high insurance premiums stemming from rating factors beyond the control of the individual. He also pointed out that LMI individuals are often offered smaller claims by insurers than their affluent peers, and are more likely to be intimidated by the claims process.

Question and Answer

An audience member asked the panel for solutions to the insurance industry's regulatory problems. **Johns** advocated working within the present system and streamlining it.

An audience member asked whether federal regulation of the insurance industry should be optional or mandatory. **Schwarcz** stated that the insurance industry cannot have a system where regulated entities have a choice of their regulator. Instead, he advocated for a hybrid approach without choice, in which the federal regulator can threaten preemption on the states if they prove ineffective.

A question was asked about consumer protection issues in the marketplace that need to be addressed. **Hill** stated that the best consumer protection is to make sure that companies will honor their commitments. **Johns** discussed the commitment of industry to regulate itself and address consumer protection issues. He noted that industry pressure through its trade group, the American Council of Life Insurers (ACLI), in one instance drove a company to address problems with an annuity product that many believed was detrimental.

Michael McRaith (Director, FIO) asked the panel whether a lack of transparency is a barrier to the growth of the retirement market for life insurance. **Johns** answered in the affirmative, and argued in favor of streamlining the system, implementing straightforward disclosure requirements, and increased speed to the market. **Schwarcz** called for a simplification of available products.

Panel Two: International Developments

Moderator:

Brian Duperreault – CEO, Marsh

Panelists:

Walter Bell – Chair, Swiss Re NA

Mark Grier – Vice Chair, Prudential

Christopher Mansfield – SVP/GC, Liberty Mutual

Eleanor Kitman – Commissioner, Texas

Discussion

Brian Duperreault (Marsh) stated that he was “struck by the immensity of this panel’s topic.” He mentioned that panelists could discuss issues such as: Solvency II, Global Systemically Important Financial Institutions (G-SIFI), the domestic complications associated with accounting standards, and the European debt crisis among others. **Duperreault** claimed to be “heartened” over the creation of the FIO and its possible involvement on the “international stage.” He stated that FIO can help insurance companies with covered agreements, representing insurance companies in foreign trade negotiations, in the opening of new markets, and the rollback of protectionism.

Eleanor Kitzman (Commissioner, Texas) claimed that a lot has been developed in the international insurance arena. She stated that U.S. insurance companies are active in the international arena and the federal government should do what it can to help with access to foreign markets. **Kitzman** noted that international insurance companies are also active in the U.S. which provides U.S. customers with more choice but means that U.S. regulators must have a means of knowing information about the foreign insurance companies. She stated that federal regulators should ensure that there is a solvent and transparent insurance industry. **Kitzman** claimed that U.S. insurance companies have a low exposure to the European debt crisis but she noted that regulators continue to monitor the situation. She stated that it is important for the U.S. to be involved internationally. She noted that the National Association of Insurance Commissioners (NAIC) allows for peer review in the U.S. insurance industry and there is the same opportunity for U.S. companies to gain exposure to other insurance approaches through international involvement. **Kitzman** stated that there are significant differences in approaches between the U.S. and international insurance regulators, with the main difference being the level of transparency. She claimed that most IAIS work is confidential and receives no outside input. **Kitzman** stated that NAIC has worked to reduce overly burdensome regulation and continues to urge the same approach in international regulation.

Walter Bell (Swiss Re) stated that Swiss Re has a common interest in improving insurance regulation. He stated that FIO is a necessary advocate in the domestic and international insurance reform dialog. **Bell** iterated the importance of supervisory colleges and group supervision in the insurance arena. He stated that insurance companies benefit from international coordination and the supervisory colleges provide a means of transparency. He explained that the European Union (EU) utilizes economic risk-based solvency monitoring while the U.S. regime is one of legal entity supervision. **Bell** noted four benefits of the supervisory college framework: (1) provides a platform for information sharing; (2) allows for routine dialog between members; (3) provides knowledge about group members; and (4) puts pressure on companies to operate in a responsible manner. He noted that before information can be shared within supervisory colleges, memorandums of understanding need to be negotiated which can take time but he stressed that these challenges can be overcome as supervisory norms increase. **Bell** stated that Swiss Re supports making supervisory colleges more effective. He also suggested that collateral reform is needed because the U.S. state insurance system is not well positioned to represent the U.S. in international matters. He stated that the states cannot speak for the other states and cannot enter into international agreements for other states. **Bell** claimed that reinsurance collateral standards need to be reformed because currently there is an un-level playing field. He stated that any reform in the states will be slow and uncoordinated; therefore, a national solution is needed which FIO could coordinate. He suggested that FIO should help to establish a mutual recognition system for state regulation of insurance. Finally, **Bell** noted that reforms in the U.S. system are urgent due to the pending EU equivalency evaluation of foreign countries under Solvency II. He stated that it is very important to achieve an equivalency determination for all insurance companies operating internationally.

Mark Grier (Prudential) stated that large internationally operating U.S. insurance companies face many challenges in international operation. He claimed that the biggest challenge is that there is no federal regulation of insurance in the U.S. and little understanding of insurance at the federal level. **Grier** stated that FIO can serve to focus on the distinctness of U.S. insurance and position the U.S. in international debate. He stated that there is a “knee jerk” reaction to attempt to fit insurance in the bank model but he stated that the banking framework is not appropriate for insurance. **Grier** suggested that FIO can play a role in establishing a distinct identity for insurance in

the U.S. He noted that accounting divergence is a very important issue for insurance, noting the negative implications of the growing international focus on accounting convergence. **Grier** stated that the distinction between solvency accounting and financial accounting is an important distinction in the U.S. In the area of systemic risk, **Grier** stated that it will be very important for regulators to understand the business models of insurance companies rather than simply labeling the companies as systemic. He stated that it is important for there to be better understanding of what statutory balance sheets are and what is involved in the recognition of liabilities. Finally, he stressed that regulations should not disadvantage an insurance company either in domestic operation or international operation.

Christopher Mansfield (Liberty Mutual) stated that thus far there has been a “thoughtful” launch of FIO. He noted that Liberty Mutual welcomes a single federal contact for insurance issues and FIO should be that contact. He suggested that FIO can “bring expertise” to assist U.S. companies address market access problems and interact with trade representatives. He noted that FIO can help establish international partnerships and represent the interests of U.S. insurance companies in international negotiations. **Mansfield** explained that risk is viewed in a different way in Europe than it is in the U.S. and Europe wants capital buffers big enough for there to never be a default. However, U.S. regulators want a “rational amount” of capital reserves because other safety measures have been worked into the system. He claimed that the guaranty funds have served the insurance industry well.

Question and Answer

Duperreault noted the Solvency II initiative in Europe, and he asked what equivalency means and whether the U.S. regulatory system can be considered equivalent. **Grier** stated that there has been intense debate around equivalency, noting that “politics and turf have come into play.” **Grier** claimed that Prudential has concerns over Solvency II because of the “pro-cyclical” nature of the Solvency II approach and the lack of comparability. He advocated for an outcomes based approach and he suggested that Solvency II might not be good for U.S. business models. **Bell** stated that Solvency II is a “country by country situation at this point.” He claimed that Solvency II will happen although it looks like it will be delayed. **Bell** stressed that companies outside Europe will need additional capital to operate within Europe. He urged that “global supervision for global companies” is necessary in order to level the playing field. He stated that the Swiss have been working with the EU on the best plan for capital reserves, and he suggested that Solvency II will also impact foreign companies’ ability to operate in the U.S. so international agreements need to strive to merge Solvency II with other regulations.

Duperreault asked whether the U.S. regulatory system is equivalent with Solvency II. **Kitzman** stated that equivalency depends on the approach to solvency that is used is either risk based or capital based. **Kitzman** noted that the U.S. has been deemed equivalent on 25 of 28 protocols released but new ones have been added. She explained that the U.S. will be reevaluated in 2014. She claimed that the U.S. has made changes where there were deficiencies and that the U.S. is largely equivalent on an outcomes-based approach.

Duperreault asked for suggestions of what FIO should focus on and what relationship there should be between FIO and NAIC. **Bell** stated that there is already a hybrid system between NAIC and state based regulation. He stressed that the U.S. needs uniform regulation and it should not allow regulatory arbitrage between state regulators. **Bell** claimed that the system of state regulation will continue to have arbitrage issues until there is some federal input. He explained that the Interstate Compact is missing the support of 25% of the states which has made it difficult for

the Compact to be effective. **Kitzman** agreed that there is not one system of regulation of insurance in the U.S. She claimed that the NAIC attempts to deal with the multiple systems and tries to bring uniformity. **Kitzman** stated that thus far it is a very “clunky” process. She claimed that the Compact was a great idea but until all states sign on, it will be ineffective. She noted that an attempt was made several years ago to implement the “State Modernization and Regulatory Transparency Act” or “SMART Act” which would leave the current state-based insurance regulatory system in place but would facilitate a major overhaul of that system and eliminate conflicting state laws and regulations. She stated that it would have created uniform standards and state based enforcement but NAIC was opposed to the bill so it failed. **Kitzman** claimed that conceptually this type of approach has some merits since the NAIC has been unable to accomplish what the SMART Act had the possibility to do. **Mansfield** stated that he “does not foresee state uniformity” and that the most that can be hoped for is coordination and consistency.

Michael McRaith (FIO) noted that IAIS has been working on a “common framework.” He asked to what extent the panelists support this approach. **Bell** stated that common framework is attractive and Swiss Re supports the idea. He stated that Swiss Re supports the use of supervisory colleges and group supervision so if a common framework and group supervision can be worked out Swiss Re would support it. **Grier** noted support for a common framework but claimed that his support would depend on the approach. He stated that group supervision is necessary for holding companies and unregulated subsidiaries. He claimed that he is cautious about how proscriptive it becomes. **Kitzman** stated that she would be open to common framework but noted that the “devil is in the details.” She questioned who would have a voice, who would be subject to the framework, and who would administer the framework. **Mansfield** claimed that the common framework is “top down and prescriptive.” He claimed that something like common framework will happen eventually but he noted concern about its impacts on competition. He stated that any approach should not put international companies at a disadvantage within their own domestic market.

Panel Three: Prudential Standards for Insurance Companies

Moderator:

Michael McRaith – Treasury Department

Panelists:

Birny Birnbaum – Consumer

Forrest Krutter – SVP/GC, Berkshire

Marlene Debel – Treasurer, MetLife

Discussion

Janice Abraham (United Educators Insurance) stated she would like to “offer some advice” on the priorities that “really need to be focused on.” She offered three questions for the conference to ponder. Her first question asked whether the possible solution being focused on was going to support solvency and financial stability. She contended that transparency, financial stability and solvency go “hand in glove” and without those three components, there exists the possibility of corruption. She next asked whether the possible solution encouraged competition. **Abraham** stated that state based regulation has done a good job promoting competition. She expressed her concern that a lack of competition would create “consolidation” in the industry, eventually leading to a firm that was “too big to fail.” She declared that she was in favor of a highly competitive and diverse insurance market. She finally asked whether the proposed solution encouraged innovation. **Abraham** stressed that innovation must be part of the insurance industry and companies should be

encouraged to create new products, “experiment” with them, and make them better. She expressed concern that small and medium firms would be “swept away” in any possible solution.

Marlene Debel (MetLife) asserted that AIG’s failures were not “core” insurance issues. She stressed that life insurance is not a risk when policy coverage with long term risks is matched with long term assets, is “highly regulated,” and has no connection with other financial issues. **Debel** agreed with current regulations to “rehabilitate” failing companies or sell their assets within the market. She noted it was appropriate for the FIO or FSOC to study whether insurance companies represent systemic risk.

Forrest Krutter (Berkshire) stated his “theme” to be that the system of state regulation is sound. He argued that the “AIG collapse showcased the finest of state insurance regulations.” He contended that during the collapse, state regulators did “what the law and policy holders asked of them” by following their own regulations. He stated that AIG met payment obligations to policy holders because state regulators made sure AIG had assets for those policies. **Krutter** noted that there was still room for improvement. He expressed concern with the new focus on unregulated insurance company subsidiaries and parent companies. He predicted that attempting to regulate those companies without understanding those companies will fail. He contended that “model worship” was leading regulators and insurance firms “astray.” He expressed his support for NAIC setting charges for various kinds of risk as a better approach to offer far stronger protection. **Krutter** strongly endorsed insurance statutory accounting and believed that the focus must be to address the realities of the industry. He concluded that it was easy to create a document promising to pay and take money when times were good, but when times got bad, the industry must still be ready to meet obligations.

Birny Birnbaum (Consumer) stated that he was “struck” while listening to the other panels when “consumer reps failed to address consumer protection issues.” He observed that any entity will choose what is best for them and not necessarily the best for all if given the choice by regulators. He stressed that consumer protection is essential for solvency and prudential oversight. He noted that insurance regulations are a “hodgepodge” where companies selling the same thing end up following different rules by different regulators. **Birnbaum** commented on the issue of a “regulatory albatross,” where state regulators would try to protect and maintain the solvency of their local firms artificially by “changing the rules” and giving the firm capital relief. He stated that this created a huge advantage for the local firm who was able to count assets that were previously excluded by the rules and now had “capital on command” through the state. He argued this showed how fragile the system can be, and it varied from each state agency. **Birnbaum** noted climate change created new risk that U.S. insurance firms are ignoring, unlike firms from other countries. He stated that insurers in the U.S. are not responding to or acknowledging climate change, and when insurer’s finally “wake-up” it would shock the market. He expressed concern for an “over reliance for black box modeling” over sound business judgment. He advocated for better regulation of products at the “nexus between insurance and banking” as well as the privatization of the flood insurance market. He concluded that the role of the NAIC must be strengthened with secure financing from the government and a transparent structure.

Question and Answer

McRaith noted that several of the panelists have stated the need to be “outcome focused.” He asked what outcomes should be looked at. **Krutter** responded that “ultimately, we’re talking about solvency.” He said he hoped to see insurance be viable to make payments for claims in fifty years, and he noted transparency and protecting the consumer as being important as well. **Birnbaum**

argued for the FIO to stress “fair treatment” of the consumer as being on the same level as solvency. He emphasized selling bad products was not a desirable outcome. **Abraham** replied that diversity and the spread of risk through the entire industry must be maintained. **Debel** expressed her agreement and added her support for an “even playing field” and transparency.

McRaith asked if the rate of failure was the best way to measure the effectiveness of a solvency regulatory scheme. **Krutter** replied that it was a “key point,” but there should also be a sense of whether people were “hanging on by their fingernails.” **Birbaum** argued against the idea that a small number of failures meant success, noting that the issue is when there are failures, consumers are protected. **Abraham** noted failures should be expected. **Debel** stated that solvency does not mean insurance companies never fail and the focus should be on paying policy holders.

McRaith stated that some have expressed concerns about a federal regulator. He asked how it was different to have “50 plus” state regulators versus a single federal regulator. **Krutter** replied that a number of concerns are somewhat “localized” which makes individual state regulation viable for those areas. He argued that insurance companies chose to operate in those markets knowing the regulations, and that the public has benefited from local regulators. **Abraham** noted that she represented a group which dealt with a single regulator, but that state regulators created inconsistencies that could create a challenge and raise costs to the consumer.

McRaith recalled the general statement that the traditional insurance business model does not present systemic risk but argued it could not be said that an insurance company may not be systemically important. He asked how to reconcile the two notions. **Krutter** contended that there were a number of systems that are important such as with railroads where one piece can make the whole fail. **Birbaum** noted that only four companies make up 90% of the title insurance market. He also expressed concern that the guaranty fund is “post event funded” and that in the event of a large failure, could be entirely drained.

McRaith asked if the panelists felt their state insurance regulators had the expertise to execute the regulatory objectives and understand the panelists’ complex companies. **Birbaum** advocated for state regulators to “catch up” to the data mining methods used by insurance firms to create better predictive models of behavior. **Krutter** argued that state regulators have advanced “in step” with the firms they regulate. He contended that their job was not to over analyze but only to see if the company can meet their obligations. **Abraham** suggested that regulators were current and they “grow as we grow.”