AFR Americans for Financial Reform

December 7, 2016

Dear Representative,

On behalf of Americans for Financial Reform (AFR), we are writing to oppose HR 5143, the "International Insurance Standards Act".[1] Particularly if Representative Duffy's amendment is included, this legislation would cripple the ability of Federal regulators to provide needed assistance in the oversight of large global insurance companies who play a central role in our financial system. Even without the amendment, HR 5143 places unreasonable and unworkable barriers on international negotiations important to the oversight of global insurance companies.

We should not forget that an insurance company, AIG, was at the center of the 2008 financial crisis and received the largest taxpayer bailout in U.S. history. The $182 billion AIG bailout went to cover losses in investment banking type activities like the sale of credit default swaps and the securities lending business. Provisions in this bill and Representative Duffy's amendment will block the ability of regulators to prevent the next AIG.

Nor was AIG the only insurance company that was a central actor in the 2008 financial crisis. Large monoline bond insurers such as Ambac and MBIA also failed in the crisis because of the irresponsible financial risks they took during the bubble period. Their failure contributed significantly to turmoil in the critical bond markets that they insured. In addition to these critical insurance company actors in the financial crisis, large life insurers took very significant losses during 2008-09 that led many to initially apply for government assistance, although only two large insurers (Hartford and Lincoln National) actually had to take government funding.

Insurance companies continue to be central to financial stability. Insurance companies purchase about one third of all investment grade bonds in the US financial system, making them a crucial source of credit in the economy. Financial troubles in the insurance sector would thus have a significant negative impact on the entire U.S. financial system and economy.[2]

As a response to the systemic risk issues revealed during the crisis, state, Federal, and international regulators are all working to improve the oversight of large global insurance companies such as those that failed or came under stress in the crisis. In the U.S. the lead role in

---

[1] Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/

[2] Schwarcz, Daniel and Schwarcz, Steven L., Regulating Systemic Risk in Insurance (December 30, 2014). University of Chicago Law Review, Vol. 81, No. 4, 2014; Minnesota Legal Studies Research Paper No. 14-18. Available at SSRN: http://ssrn.com/abstract=2404492

insurance regulation is and will continue to be played by the states. But the inherently local and decentralized nature of state-based regulation means that it does not address all the systemic risk issues created by the largest global insurance companies, especially when they engage in financial activities that more closely resemble investment banking than traditional insurance.

For example, prior to the financial crisis state regulators did not effectively control risks in AIG's activities related to complex financial derivatives, most of which were conducted in London, or its nationwide securities lending activities. State regulators are also not equipped to take into account the spillover effects on other parts of the financial system that can be created by failure or financial stress at large insurance companies.

HR 5143 and Insurance Regulation

HR 5143 would interfere with the capacity of Federal regulators to participate in insurance regulation, and would do so in a manner that is both harmful and unnecessary. The bill's provisions related to international agreements are unnecessary since international insurance negotiations do not create binding U.S. law. Policy agreements reflected in international agreements only take effect if there is a regulation promulgated by a U.S. Federal or state regulator in accordance with U.S. law, including notice and comment for any applicable regulation. Thus, the provisions in this legislation that, for example, require notice and comment processes for these non-binding international agreements are redundant and unnecessary.

Numerous other provisions in HR 5143 would also be actively harmful, particularly if Representative Duffy's amendment is included:

- Title II of the bill, as added by Representative Duffy's amendment, would place unprecedented new restrictions on the ability of the Federal Reserve to carry out its basic responsibilities in regulating the solvency of large complex insurance companies. If this provision passed, any significant Federal Reserve regulation affecting insurance companies would have to be approved by a joint resolution of Congress in order to take effect. This requirement would have a devastating effect on the ability of the Federal Reserve to protect the public from the next AIG by addressing the gaps in state-based insurance regulation.

- Section 4(a)(2) of the original bill requires that any new agreement related to insurance capital must be "consistent with capital requirements set forth in the state-based system of regulation", while Section 3 paragraph 8 of the bill requires the Treasury and the Federal Reserve Board to achieve "consensus positions" with state insurance regulators before any insurance-related discussions with international regulators. Since each of the fifty states has their own insurance regulator and the ability to set forth their own insurance capital standard, which may and often does differ from the model standards recommended by the National Association of Insurance Commissioners (NAIC), this

vague directive would apparently mean that any individual state could effectively make it impossible to reach any international agreement or even engage in international discussions. Any single state insurance regulator could block consensus and make international agreement on insurance standards impossible. Since state insurance capital standards are themselves not always consistent, it is difficult to see how an international agreement could be consistent with all of them.

- Section 3 Paragraph 10 of the legislation instructs U.S. negotiators that they must "avoid measures that could limit the availability and accessibility of risk protection and retirement security provisions that are essential to meeting the needs of aging populations". According to consumer advocates, this language could force U.S. regulators to oppose improved consumer and financial protections in the area of, for example, annuity products – a rapidly growing sector that accounts for hundreds of billions of dollars in insurance premiums and has been linked to serious consumer and investor protection issues.[3]

- Section 4(b)(3) of the bill mandates that proposed international solvency standards for insurance companies must be designed "***solely*** to ensure that sufficient funds are available to pay claims to an insurer's policyholders" [emphasis added]. While policyholder protection is clearly a critical goal, this mandate would prevent regulators from addressing critical risks to the economy created by activities at large insurance companies. For example, this provision would have banned insurance regulators from establishing standards to prevent the failure of AIG by requiring that AIG had sufficient resources to pay its credit derivatives and securities lending counterparties. It would also prevent standards that ensure insurance companies to hold sufficient resources to protect themselves from sudden, disorderly liquidation of their corporate bond portfolios, which would be extremely disruptive to the U.S. economy.

These and other provisions in the bill would make it impossible for the Federal government to perform its critical role in ensuring the oversight for large global insurance companies.

Thank you for your consideration. For more information please contact AFR's Policy Director, Marcus Stanley at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

[3] According to the Insurance Information Institute, annuity products account for over half of all life insurance premium income. See http://www.iii.org/fact-statistic/industry-overview . According to the Financial Industry Regulatory Authority (FINRA) "Due to the complexity and confusion surrounding them, which can lead to questionable sales practices, variable annuities are a leading source of investor complaints to FINRA.".