



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

FEDERAL ADVISORY COMMITTEE ON INSURANCE

MEETING MINUTES

WEDNESDAY, NOVEMBER 14, 2012

The Advisory Committee met on Wednesday, November 14, 2012, in the Cash Room at the U.S. Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C., Brian Duperreault, Chairman, presiding.

MEMBERS PRESENT:

BRIAN DUPERREAULT, Chairman  
BIRNY BIRNBAUM  
MICHAEL CONSEDINE  
JACQUELINE CUNNINGHAM  
JOHN DEGNAN  
ROBERT EASTON (proxy for Benjamin Lawsky)  
LORETTA FULLER  
\*SCOTT KIPPER  
THOMAS LEONARDI  
MONICA LINDEEN  
\*SEAN McGOVERN  
\*MICHAEL SPROULE  
WILLIAM WHITE

ALSO PRESENT:

MICHAEL McRAITH, Director, Federal Insurance Office  
JIM BROWN, Designated Federal Officer, Treasury Department  
ED CONNOR, FEMA Deputy Associate Administrator for Insurance

\*Participated via telephone

Chairman Duperreault called the meeting to order and welcomed everybody. He acknowledged that he is retiring from Marsh & McLennan at the first of the year. After discussing it with Director McRaith, he will continue to be the chair of the Advisory Committee. Mr. Duperreault thanked Director McRaith for the opportunity to continue to serve on the committee.

Director McRaith welcomed everyone and thanked them for their continued participation. He acknowledged that the committee members' time is valuable and expressed appreciation for their involvement. He also indicated that part of the meeting would involve a discussion of Superstorm Sandy and would include a presentation by Ed Connor of the National Flood Insurance Program (NFIP).

Chairman Duperreault then asked for a motion to approve the minutes of the August 6, 2012, meeting of the Federal Advisory Committee on Insurance. The motion to approve the minutes as presented was made, seconded and approved unanimously.

Chairman Duperreault introduced the first order of business, Super Storm Sandy. He indicated that since the storm affected a number of the states represented on the committee by insurance regulators, it was appropriate to hear from them and others of the group on their thoughts and experiences from the storm.

With that as a preface, he called on Robert Easton, the Executive Deputy Superintendent of the Insurance Division at the New York State Department of Financial Services to outline events in his state.

Mr. Easton explained that he was sitting in for committee member Superintendent Ben Lawsky who couldn't attend because he is deployed by the Governor to provide Sandy-related assistance to affected areas. Mr. Easton gave an overview of the damage done by the storm and the

efforts made by his Department to respond to the needs of the insurance consumers of his state. Mr. Easton was complimentary of the cooperation exhibited by the Federal Emergency Management Agency (FEMA).

Chairman Duperreault then announced he would ask each of the members for their observations regarding the storm and its aftermath.

Commissioner Lindeen commented on the availability of resources from other state regulators to help the affected areas and specifically mentioned the collaboration by many states on an impending data call and that the National Association of Insurance Commissioners (NAIC) had set up a phone bank to help with insurance inquiries.

Commissioner Consedine indicated that Pennsylvania was impacted by Superstorm Sandy, and suffered a loss of life and significant property damage. He also noted that this was the second 100-year event in less than two years in the northeast. The level of activity in this part of the country underscores the need to formalize what has been a very good collaboration at the state and federal level.

Commissioner Leonardi echoed what Commissioner Consedine and Superintendent Easton said. He noted that the flood line of business experienced a significant amount of the damage. He further indicated that there might be some wind/water type claims as there were in Katrina, although because the extent of the sustained force winds were not nearly as great as Katrina's it may be less of an issue.

Commissioner White acknowledged that there was not comparable damage in the District of Columbia as occurred to the north. He observed that the frequency of severe losses, looking back over the past 25 years, has increased dramatically. The concerns that are raised by this ongoing new

level of catastrophic events are something that has to be addressed not only from an insurance standpoint, but from an overall financial perspective.

Commissioner Cunningham stated that Virginia was spared the brunt of the storm. Although the damage in the Commonwealth has been minimal, she has been pleased by the response of the insurance companies. She echoed Commissioner Lindeen's remarks regarding the NAIC. The Commissioner stated her willingness to help and pointed out that as members of the Southeast Zone, Virginia has had its share of experience dealing with hurricanes.

Mr. Degnan stated that from a carrier's viewpoint, he was very pleased and grateful for the reaction of the regulators to the crisis. He indicated that as has usually been the case, regulators have been receptive to insurer issues. He did suggest that regulators consult with insurers prior to making public statements on things like the applicability of hurricane deductibles. He pointed out that with prior consultation, when a Governor speaks to the issue, he can say, "We don't believe that the deductible should apply. And the following companies have already signaled to us that they will not be applying a deductible." This could minimize insureds' concerns if their carrier is listed.

Mr. Birnbaum thanked the state and federal agencies and the insurers for all of their efforts, not only in post-storm recovery, but also pre-storm preparedness which saved lives. He then spoke about other issues that the storm brought out including the need for a national catastrophe insurance policy. Flood is a separate coverage, requiring a separate purchase by homeowners, with the result that a relatively small percentage of consumers who need flood coverage actually purchase it. He went on to say that there is a need to develop a national catastrophe insurance policy based on loss mitigation, otherwise there will be no insurance mechanism which will cover ever-increasing losses.

He also offered his support for the Federal Insurance Office (FIO) to look for a way to phase out the NFIP and to move flood coverage to the private market by creating a homeowner's policy which covers flood, provides all of the efficiencies of a multi-peril policy, promotes loss mitigation efforts by insurance companies and actually provides consumers, both personal and business, with the kind of protection that they expect and that they need to protect financial assets.

Ms. Fuller commented on the problem that some of the areas of D.C. and Maryland are not in a flood zone. Consequently, some clients don't understand that even if you are not in a flood zone you still may need flood insurance. In addition, clients who had flood insurance and suffered damage in their basements weren't covered. She supported Mr. Birnbaum's concept of a multi-peril policy that includes flood protection by pointing out that under a multi-peril policy, the insured would only have to contact one company to handle a claim as opposed to having a claim adjuster for the flood insurance and a claim adjuster for the homeowner's insurance as is now the case.

Mr. McGovern offered that it is a testament to the financial strength of the industry, that there is no indication that any insurer or reinsurer is likely to be threatened financially by Sandy. Acknowledging that there is still a long way to go on the relief effort, he stated that it would ultimately be a lot worse if we did not have the financial wherewithal to address the situation.

Mr. Sproule limited his remarks since his company does not offer products with significant exposure to these types of claims. He suggested that it is time for all of us to remember that whether you're a regulator, insurer, consumer advocate, it's time to help our affected communities.

Commissioner Kipper said that he had spent a lot of time in Louisiana following Katrina, and was heartened by the response of the industry and regulators who are applying lessons learned from that storm to the tragedy that had recently taken place. He added support for Commissioner White's comments on the impact on the financial market since more and more of these cataclysmic

events are taking place. He suggested that there is a need to study these events and formulate a more standardized response.

Chairman Duperreault then called on Ed Connor of the Federal Emergency Management Agency (FEMA) to provide his organization's perspective on Sandy.

Mr. Connor started by expressing his appreciation for the favorable comments which had been made concerning FEMA's response to the storm. He explained that FEMA operated using the "whole community concept," which called for all affected parties, government and private to be included in one organization. Some 15,000 federal employees were deployed to affected areas as part of this concept. They worked alongside state employees, insurance company personnel and volunteers to address the needs of storm survivors.

In talking about the NFIP, Mr. Connor indicated that the losses from Sandy were likely to be staggering and would be additional to substantial debt that remained from Katrina. He indicated that although the Program's projections were only in the preliminary stage, claims could amount to between \$6 to \$12 Billion Dollars. It is likely that if these projections are correct, the program will have to seek additional funding from Congress.

He then detailed some of the outreach efforts being made by the Program including regular conference calls with the NAIC.

Mr. Connor then gave the Committee an overview of the Biggert-Waters Act. The law provides for a 5-year extension of the authorization for the NFIP. It also mandates that rates for insurance will be actuarially sound.

Mr. Connor then responded to several questions regarding rate increases.

Director McRaith invited Mr. Connor to attend the Committee's March 2013 meeting to discuss the NFIP in more detail and Mr. Connor indicated that he would attend that meeting.

Chairman Duperreault then moved to reports from the three subcommittees and called on Commissioner White for his presentation.

Commissioner White stated that Subcommittee I is looking at affordability and accessibility of insurance in the context of changing demographics and socio-economic factors. He indicated that there had been two meetings of the subcommittee where three areas of research were identified.

First, the growth in international markets is going to change the level of competition. It will probably open up new areas of opportunity, particularly for personal lines and individual consumers, and this will pose new challenges to regulators.

Second, the greatest impact will be on personal lines because of the anticipated demographic changes i.e., the shift away from the U.S., the EU and Japan due to their aging populations and the emergence of new markets in Asia and Latin America.

Third, the impact on producers will be significant because it will be the producers who will be marketing the coverages and providing the kind of advice and information that consumers will need. By necessity, this will also involve regulatory concerns with regard to licensing of those producers as well as monitoring the markets and insurers' and producers' performance in those markets.

In response to a question from Commissioner White regarding the coordination of subcommittees' work products, Director McRaith stated his view is that the subcommittees should form independent recommendations based on the questions that have been posed, then in full

committee meetings have discussions about how the three interact, where is there overlap, where there are complementary recommendations.

At this point, Chairman Duperreault thanked Commissioner White for his presentation and recognized Member John Degnan for his report from Subcommittee II.

Mr. Degnan started by suggesting that the release of the Federal Insurance Office Report on regulation will be helpful for each of the subcommittees accomplishing their objectives.

After recognizing that more detailed work needs to be done, he then summarized his group's responses to the questions posed.

Mr. Degnan cited one overriding issue around which there was consensus. He stated the group's belief that the insurance industry is unique in its structure and its regulatory environment. It was agreed that if insurance is to be aligned with broader financial services entities regulation, the aligned regulatory regime should be sensitive to and reflective of those differences. If not, then the regulation will likely be redundant and burdensome in a way that adversely impacts the ability of both the regulators to monitor the industry and the companies to perform.

Secondly, there was concern among the committee that recent initiatives seem to be more bank-centric than insurance informed and may not sufficiently incorporate what is unique about the insurance industry.

Thirdly, there was acknowledgment that for supervision and regulation to be effective, it does have to be collaborative with other financial services sector as long as it doesn't create undue burdens.

Fourthly, a lack of transparency and lack of understanding about the insurance industry can cause the application of faulty financial services stress tests which could lead to erroneous conclusions and unduly unsettle the marketplace.

Some of the group believes that the existing U.S. system of multi-jurisdictional group supervision including the NAIC, "window and walls approach", Own Risk and Solvency Assessment (ORSA) and the Model Holding Company Act that the NAIC has produced already provides a sufficient view into non-insurance entities that are a part of a group. There were some on the committee that acknowledged the need for some macro-oriented supervision of the group as an overlay to the operating insurance entities.

As to the question of regulatory compatibility, there was a concern widely shared among the group that words like "equivalence," or "harmonization," or "convergence," imply the need for a single global regulatory regime for which there was no support on the subcommittee, particularly because it wouldn't accommodate the unique legal demographic and geographical considerations that drive insurance markets in different jurisdictions.

There was no support among the group for a single global regulatory regime. There was sentiment that there should be resistance to altering a system in the United States that has been historically strong, solely because there is a bias among our European colleagues for a developing model in Solvency II. Mr. Degnan personally praised Director McRaith for his increased role he has played in the international community.

Mr. Degnan then dealt with the question of what is the connection between the regulation of an insurance market and participation in that market by insurers. He stated that the group felt that there is a direct correlation between regulatory oversight and willingness on the part of players in the marketplace to compete and participate.

The last point on this topic was a concern about a perceived dichotomy of prudential supervision, as it is developing in the U.K., being divorced from the appropriate requirements that are focused more on consumers and protecting market conduct supervision. Although the same dichotomy exists in many of the 50-state regulatory regimes, he reported that the group believes that in most states the proper balance has been struck by the regulators.

Mr. Degnan went on to say that there was disagreement on what U.S.-based limitations exist for U.S.-based insurance firms when they are operating in foreign jurisdictions. Some members believed that the absence of a single national authoritative regulatory regime in the United States puts U.S. companies at a competitive disadvantage in dealing outside the U.S. Others pointed out that there are certain requirements in federal law, like the Foreign Corrupt Practices Act, which does have an impact on the ability to effectively compete outside the U.S.

Mr. Degnan addressed whether the state-based system of regulation in the U.S. is equipped to support insurers who are domesticated here, but are expanding into other jurisdictions and whether there are gaps or issues in the regulation of the U.S. insurance sector that limits the ability to compete. The group decided to defer these issues to Subcommittee III.

Mr. Degnan reported that there was a robust discussion among the members about whether it is desirable for the group supervision to impose a single prescriptive approach toward capital.

The group recognized that each regulator around the table and throughout the U.S. is fettered by the legal construct within which they exercise their authority as regulators. And not all states adopt every recommendation of the NAIC, so the idea that U.S. regulators could, even if they wanted to, conform to some prescriptive approach toward capital ignores the essential federalism of our nature.

As Mr. Degnan's final point, he stated that there was a strong consensus that the emerging experience of group supervision ought to inform ComFrame as it develops rather than having the cart lead the horse. With that, Mr. Degnan concluded his report.

Chairman Duperreault thanked him for his comments and opened the floor to comments and/or questions.

Mr. McGovern offered his observation that the term "equivalence" has become somewhat loaded but it would be wrong to leave with the impression that international businesses, as a general rule, are not supportive of greater levels of harmonization in the way that various national operations are supervised. He continued that convergence and harmonization have been a consistent theme in the international insurance sector for many years. They are the foundation of the development of the insurance core principles by the International Association of Insurance Supervisors (IAIS).

He indicated that while there may be some particular difficulties around some particular initiatives, sight should not be lost of the need to try to introduce and have better practices across regulatory standards. Although it may be a pipe dream to expect that there will be a single global construct, the insurance industry should try to learn from different regulatory systems around the world and drive towards greater levels of similar standards, he maintained. This is not only in the interest of regulatory efficiency. It should also be in the interest of avoiding regulatory arbitrage internationally.

Mr. McGovern then addressed an earlier point regarding the U.K. which is moving away from integrated solvency and market conduct regulation to a twin peaks solvency and market conduct regulatory structure as are other countries such as exists in Australia, New Zealand and The Netherlands. Unlike the U.S. regulatory structure which mandates approval of both rate and forms

filings, thereby tying rates and forms much more closely to company solvency, it is easier for the U.K. to construct a regulatory model that looks at market conduct issues separately from solvency issues.

At the conclusion of Mr. McGovern's remarks, Chairman Duperreault asked if there were any other comments. Hearing none, he thanked the subcommittee for their work and recognized Mr. Easton for Subcommittee III's response to the posed questions.

Mr. Easton thanked the subcommittee members for their work especially in light of the disruption to their schedules necessitated by Superstorm Sandy.

Mr. Easton started his report with a summary of the first issue the group focused on which was the concept of group supervision, its definition, role and authority. The discussion coalesced around the concept that the group supervisor really should be first among equals. The role ought not to be one of omnipotent power, but rather, one of coordination, collaboration, communication and cooperation among regulators and affected stakeholders. The consensus of the group was that the chief roles of a group supervisor are to spearhead and facilitate dialogue, to lead supervisory colleges and to provide an interactive forum for stakeholders.

As to how the lead is determined, the consensus of the group is that in almost all cases it will be self-evident based on where a premium is written, where company employees are located and on company history.

There was discussion about the scope of authority of the lead and the group felt that the lead's authority really has to be earned and not bestowed.

There was discussion about group capital and the movement of capital within the holding company system, and whether or not a group supervisor can and should be able to mandate

particular allocations. There was acknowledgment that regulation as it currently is done at a legal entity level creates a local bias. However, in the absence of a super-legal global structure, it was unclear to what extent capital can be mandated to be moved within a holding company system.

In discussions about movement of group capital there were questions about legal authority but suggestions that consumers could suffer. An example of such a situation would be where companies needed to hold more capital at a group level even when there weren't concerns about solvency at the legal entity level. In those instances the cost of capital could be passed on to policyholders and consumers in the form of increased premiums.

There was also discussion that ORSA, which is going to become an accreditation standard in 2015, does acknowledge that group capital is part of the risk assessment process that companies should undergo as part of Enterprise Risk Management (ERM). The group recognized that certain concepts of ERM and the supervisory colleges would require legal changes to be fully and effectively implemented in the U.S. Some aspects proved a little bit more troubling to the subcommittee.

Mr. Easton reported that there was also discussion of the importance of distinguishing between those internationally active insurance groups that might be systemically risky and those that are internationally active, but do not warrant the systemic risk designation.

The group also talked about how group supervision fits with consolidated supervision. Some committee members are overseeing companies where the Federal Reserve presumably either will or currently is involved in looking at the group's financial wherewithal.

With respect to ComFrame, the group discussed whether its adoption would require changes to the U.S. approach to group supervision and would such changes benefit U.S.-based

insurance industry and consumers. It concluded that parts of ComFrame are unquestionably seen as beneficial.

Mr. Easton commented on the group's reaction to the impact of ComFrame on the U.S. market and on insurers who operate only in the U.S. Even though ComFrame is being developed to be applicable only to those companies that are internationally active insurance groups, there is a sense of the subcommittee that it would have a negative impact by creating an overlay structure which could be potentially disruptive and create arbitrage opportunities.

Views were also expressed that international activity and diversity are often a source of strength and can actually lead to a lower risk profile. The group expressed concerns that by subjecting companies to a possibly more invasive regime that ComFrame contemplates, U.S. companies could be discouraged from expanding outside the country. There could be rating agency implications as well, if ComFrame could redefine from a rating agency perspective how an insurer manages capital.

Finally, Mr. Easton commented on the group's discussion comparing how banking rules are being developed versus the development of possible insurance rules. It was noted that the Basel 3 process has been a very consensual process. There were concerns that the IAIS and the ComFrame initiative are overly Eurocentric in nature. There were also some concerns articulated that IAIS continues with the ComFrame initiative even though there have been a number of objections voiced by industry and a number of regulators.

The group concluded that there is a lot of merit to ComFrame, but that it might behoove everybody involved in the development of the initiative to focus on those pieces that address the chief concerns that seemingly had arisen out of the 2008 economic crisis. In that regard ERM and the supervisory college process were lauded.

Chairman Duperreault thanked Mr. Easton for the report and recognized Commissioner Leonardi for his comments.

Commissioner Leonardi commended Mr. Easton spearheading and moderating the committee conversation in the midst of this incredible aftermath of the storm.

Chairman Duperreault recognized Mr. McGovern for his comments.

Mr. McGovern stated that the sense coming out of the subcommittee is that there is a lot of merit in ComFrame, there is a lot that can be agreed upon, and we should be building on what can be agreed upon rather than arguing about what cannot be agreed on.

Chairman Duperreault recognized Mr. Sproule for his remarks.

Mr. Sproule stated that there is a big difference between trying to develop consensus-oriented international standards as opposed to actually moving beyond that to coordinated rulemaking at a global level without having anything resembling an appropriate global legal framework to support it.

Chairman Duperreault then recognized Director McRaith for his reaction to the subcommittee reports and for an update on international developments.

Director McRaith thanked each of the subcommittee chairs for their reports and every individual who participated in the calls. He stated that these are not simple issues and it is very helpful to hear what committee members think. He indicated his intent to participate personally in the subcommittee discussions in the future in order to address some of the concerns expressed and to focus on the substance of the issues.

In response to Mr. Degnan's comments regarding research capabilities, the Director stated that public hearings on specific matters might well be appropriate and that the FIO is now building substantial resources internally and will be able to offer more support for the subcommittees.

Director McRaith went on to comment on the two major work streams of the IAIS. The Technical Committee work stream involving ComFrame for the Supervision of Internationally Active Insurance Groups had a very constructive meeting in Washington, D.C. in October and is continuing this week. The Solvency and Actuarial Subcommittee also met in Washington. The Accounting and Auditing Committee is meeting in Basel this week, as well. There is a meeting of the Insurance Groups Supervision Committee next week in Basel.

The Director stated his belief that ComFrame will continue to evolve, and will reflect many of the contributions and views that were in some ways commented on today. The observer comments have been well received, and the work on a document that makes sense for supervisors and for industry around the world is well underway.

The IAIS Financial Stability Committee is continuing its work to identify globally significant insurance institutions. It asked for recommendations from the IAIS by the end of the first quarter in 2013, and at this point the work remains on schedule. He acknowledged the great work of NAIC staff and Commissioner Leonardi who have been involved with that process for a long time. The FIO has been involved since last July and continues to advocate for a methodology that resembles the Financial Stability Oversight Council process.

At the conclusion of the Director's report regarding IAIS activities, he asked if any members had comments.

Commissioner Leonardi complimented the Director for his report and added that regarding the Financial Stability Committee's measures, the comment period is still open for about another month and he encouraged anybody who has comments to get those into the IAIS.

Director McRaith then remarked that one important initiative is to increase the participation of consumer advocates in the IAIS process. The FIO will be supporting that objective and is eager to have the contributions of Mr. Birnbaum and his colleagues as international standards are developed. With respect to other international matters, the Director mentioned the EU/U.S. insurance dialogue. He indicated that there was a very productive public hearing in Washington on October 12<sup>th</sup> and then again in Brussels on October 16<sup>th</sup>. The process generated some very interesting comments from observers. The Director stated his belief that the report generated through the dialogue was the most constructive work-product produced in this type of dialogue and there was support for the project to continue through 2013 and beyond with specific objectives each year.

He congratulated colleagues from the EU: Gabriel Bernardino, Karel van Hulle, Ed Forshaw of the U.K.; Terry Vaughn of the NAIC; and Kevin McCarty of Florida for their constructive and collaborative engagement throughout the year.

The Director indicated that there were comments on aligning ORSA requirements for the U.S. and the EU and also comments largely in support of the modernizing of reinsurance.

With that final point Director McRaith's report on international matters concluded.

Chairman Duperreault then turned to the final agenda item which was the setting of dates for meetings in 2013. He announced the following dates: March 13th, June 12th, December 11th, and September to be determined.

The Chair asked if there was any new business to come before the committee.

Director McRaith then congratulated the Chairman on his storied career in the insurance industry and expressed his gratitude that Mr. Duperreault has agreed to remain as chair of the committee.

The Chairman thanked the Director and adjourned the meeting.