DEPARTMENT OF THE TREASURY
FEDERAL ADVISORY COMMITTEE ON INSURANCE (FACI)

SUMMARY - 11 May 2017

The Federal Advisory Committee on Insurance (FACI) convened at 1:00pm on 11 May 2017 in the Cash Room at the US Department of the Treasury, 1500 Pennsylvania Ave., NW, Washington, DC, with Daniel Glaser, Chair, presiding.

In accordance with the provision of the Federal Advisory Committee Act, the meeting was open to the public.

Committee Members Present:
DANIEL GLASER, President and Chief Executive Officer, Marsh & McLennan Companies, Inc., Chair
DAVID (BIRNY) BIRNBAUM, Executive Director, Center for Economic Justice
KURT BOCK, Chief Executive Officer, COUNTRY Financial
QUINCY BRANCH, President and Chief Executive Officer, Branch Benefits Consultants
ELIZABETH BROWN, Associate Professor, College of Business, University of Wisconsin - La Crosse
JOHN FRANCHINI, Superintendent, New Mexico Office of the Superintendent of Insurance
MARK GRIER, Vice Chairman, Prudential Financial, Inc.
GEORGE KEISER**,** Representative, North Dakota House of Representatives
JAMES (JIM) KELLEHER, Executive Vice President & Chief Legal Officer, Liberty Mutual Insurance
THEODORE (TED) MATHAS, Chairman, President & Chief Executive Officer, New York Life Insurance Company (by Proxy: George Nichols III)
TERESA MILLER, Commissioner, Commonwealth of Pennsylvania Department of Insurance
AL (ALFRED) REDMER, Commissioner, State of Maryland Insurance Administration (by Proxy: Catherine Grason)
MARGUERITE (JAUNITA) SALAZAR, Commissioner, State of Colorado Division of Insurance
CHRISTOPHER SWIFT, Chairman and Chief Executive Officer, The Hartford (by Proxy: David Robinson)
MARIA T. VULLO, Superintendent, New York Department of Financial Services (by Proxy: Scott Fischer)
KATHERINE (KATIE) WADE, Commissioner, State of Connecticut Insurance Department
LAURA BISHOP, Executive Vice President and Chief Financial Officer, USAA (by Proxy: Douglas Ward).

Committee Members Not Attending:
AMY BACH, Executive Director, United Policyholders
THEODORE (TED) NICKEL, Commissioner, Wisconsin Office of the Commissioner of Insurance

ALSO PRESENT:
STEVEN SEITZ, Deputy Director, Federal Insurance Office, US Department of the Treasury
CHESTER MCPHERSON, Designated Federal Officer, US Department of the Treasury
DANIEL MCCARTY, Federal Insurance Office, US Department of the Treasury

Welcome and Introduction

FIO Deputy Director Steven Seitz welcomed committee members who were able to attend the second FACI meeting of 2017. He gave a brief history of the role of the FACI and its mandate to present advice and recommendations to the Federal Insurance Office. He then turned the meeting to Chairman Glaser.

Chairman Glaser welcomed the FACI members. Chairman Glaser noted that former West Virginia Insurance Commissioner, Mike Riley, resigned from FACI and that he was thankful for Commissioner Riley's service.

Chairman Glaser emphasized that FACI helps FIO fulfill its important role. He then thanked all members for their contribution.

Discussion of the Cyber Insurance Market

Mr. Glaser introduced the "Cyber Insurance Market" portion of the meeting by noting that cyber insurance is estimated at around $3 Billion in premiums, primarily in the U.S. Mr. Glaser then introduced the first presenter: Mr. Matthew McCabe, Senior Vice President and Assistant General Counsel of Cyber Policy at Marsh to share his thoughts. Mr. McCabe focused his presentation on the current state of cyber insurance market, including capacity, terms of purchasing trends and growth in the industry and the adequacy of capital and aggregation risks

Mr. McCabe opened by discussing the three components of cyber coverage: cyber events, system outages or lost revenue from the event, and cyber-related litigation. Mr. McCabe explained that Marsh has experienced incremental increases in cyber take-up rates every year since 2014 and that, in that time, growth has been substantial, with much of the growth being attributed to companies that collect substantial personally identifiable information.

Mr. McCabe reiterated chairman Glaser's statement that overall premium in the cyber insurance marketplace is at about $3.25 billion, up from $2.75 billion the previous year. McCabe noted that some estimates show overall premium could climb to $10 billion by the end of the decade and that capacity is climbing, which has led to a renewed interest from large companies in purchasing cyber insurance.

Citing the recent airline outages, Mr. McCabe also discussed the importance of addressing and insuring system failure, which resulted from bad programming updates. McCabe noted that a prolonged outage can have cascading effects on businesses.

Mr. McCabe then discussed three types of risk aggregation: widespread vulnerability (i.e. there is a vulnerability within systems that is so common that many insurers can have the same problem), cascading consequences (i.e. an event where the trigger naturally continues in the aftermath into the overall economy), and aggregated risk. Mr. McCabe concluded by suggesting that insurance companies would be leaders as it relates to designing or recommending the defenses and identifying the vulnerabilities for industrial control systems.

Discussion of the Effect of Technological Advances on Insurers' Corporate Strategy

Ms. Marie Carr, Principal Price Waterhouse Coopers (PwC) then spoke on how technology development is influencing the insurance industry.

Chairman Glaser introduced Ms. Carr by explaining that new technology is impacting all lines of insurance: personal, commercial, life, health, and group. All are being disrupted or changed to one extent or another by technology, whether it's usage-based insurance, the internet, artificial intelligence, and social networking.

Ms. Carr explained that disruption is the new normal in the insurance industry: senior executives at insurance companies are concerned about the amount of change. There are four key areas from which the concern is derived: first, 83% of executives are concerned about the speed of change; second, customer behavior—e.g. wanting prompt claims payments, third, new entrants into the market, and fourth, insurtech. Ms. Carr also explained that new technologies drive new risks, which has led to a focus on how to have better risk management platforms.

Ms. Carr also noted that there are three basic models for how insurers are approaching InsurTech: First, there are innovation hubs which have the advantage of being an internal team. There is also the internal incubator model, using ideas that are both inside and outside the company, with an eye toward the best ideas. Finally, there is venture capital model, where ideas come from outside the corporation or a new division of the company.

Ms. Carr explained that the challenges and opportunities with respect to InsurTech are primarily related to meeting the needs of customers. A second issue to consider is how to analyze the vast amount of information available to insurers so as to be able to develop better products, and have better service.

Discussion of Insurer Infrastructure Investment Practices

Chairman Glaser introduced the final topic and explained that infrastructure investments are: generally long duration, which may provide a good match for long-term liabilities; relatively illiquid, which could increase portfolio diversification; and that they provide an opportunity to lend money to sectors in need of funding.

Mr. Milum Livesay, Vice President of Accounting Policy, TIAA, and the Chairman of the Infrastructure Investments Working Group of the American Council of Life Insurers presented first.

Mr. Livesay explained that infrastructure investments are important for insurers because of the fact that they are typically long duration and, as such, generally match well to the asset liability management processes. In addition, infrastructure investments are stable and secure: they are robust and predictable. They provide certainty and guarantees. They have competitive spreads in the 150- to 250-basis point range, similar default patterns to corporate bonds, higher recovery rates, and lower rating volatility when looking at corporate bonds.

Mr. Livesay then turned to a case study: an example of I-595, which TIAA has a 50% stake. Here Florida awarded a public private partnership (P3) to design, build, finance, operate, and maintain the I-595 corridor with a long-term commitment of 35 years which is a win to TIAA and a win for the citizens of Florida. There are challenges, however. The first is getting the right information to the right people at the right time in order to close deals. There is a challenge to navigate the requirements of multiple agencies in order to get approvals. Standardization and collaboration among governmental agencies as needed with concurring, not sequential, processing of these reviews. That's something that cannot be handled by an insurance company per se, but it is something that requires collaboration between government agencies at the federal and state levels.

The second item Mr. Livesay discussed were "deal-stopper" issues. He noted that these issues are not credit-related, which might be typical of a lot of investments. Instead, these are centered on the contractual nature of these investments and the structuring issues we face. Collateral evaluation can also be a problem with this asset class.

The third item discussed by Mr. Livesay was the NAIC filing process, and, in broader terms, the process of once deals come to the point of coming to market, that they are then taken to the NAIC. Here again, the issues addressed with the funnel and the deal-stopper are the same issues that are frequently the ones that the NAIC faces in evaluating these deals. They are complex, complicated, and not uniform. One of Mr. Livesay's suggestions is a regular forum called a partnership of sorts of regulators and industry who can assess these types of transactions, create a framework, something that would allow us to be able to look at these using key principles of evaluation.

Mr. John Tanyeri, Managing Director and Head of Infrastructure and Project Finance at MetLife presented next. Mr. Tanyeri opened by discussing the importance of infrastructure investments to MetLife. He then discussed 3P's and explained that they typically involve some type of contractual arrangement between a public agency and a private sector entity for the delivery of some facility and some services. This contract should really include detailed descriptions of the responsibilities, the risk sharing, and the benefits of all traditional 3Ps.

Mr. Tanyeri then noted that the global market for 3Ps, was approximately $80 billion in 2016 and the U.S. had a record year of about $10 billion and that there was more investment in the U.S. than the rest of the world last year, the first time this has occurred in over a decade. He also noted that the American Society of Civil Engineers just released their latest report card on infrastructure and that the U.S. received a grade of D-plus. He noted the significant infrastructure needs in the U.S. and stated that between now and 2025 the U.S. needs to have about $3.8 billion of infrastructure invested. Out of that, the U.S. has about $1.8 or $1.9 billion currently funded, leaving a deficit of $1.5 to $1.7 billion.

Mr. Tanyeri praised President Trump's initiative on the matter due to the reliance on private financing and we think that's probably the quickest and best way to actually aggregate large sums of money that is currently sitting on the sidelines, waiting to be invested in U.S. infrastructure.

Mr. Tanyeri suggested that there needs to be a standard document for insurers to complete and that states should be educated on the benefits of 3P. He suggested that the federal government step in and help provide oversight to move programs forward and assist in their growth. He also explained that the ability to shorten the front end of a 3P project is essential and that competition should be the foundation of any 3P.

Mr. Tanyeri also suggested that the public sector have a dedicated team for any of the 3P projects. This would allow that unit really to be involved from inception and take a look at how that project has evolved all the way through the negotiation phase.

Mr. Dale Thatcher, former Chief Financial Officer of Selective Insurance Company of America and special consultant to the American Insurance Association presented next. Mr. Thatcher began by noting the differences between the life and P/C markets, specifically with respect to the duration of liabilities, and noted that P/C liabilities are much shorter in duration than those on the life side. Essentially, the long duration and the lack of liquidity goes beyond what a P&C investment portfolio would normally be looking for. And, although some percentage of assets may be invested in 3P, p/c insurers will not be big players until the marketplace becomes deeper and more robust with some level of securitization entrenching that may make such an investment more interesting.

Finally, Mr. Joshua Zwick, Partner at Oliver Wyman presented. Mr. Zwick opened by noting that infrastructure is not monolithic, but that there are commonalities, including permanent facilities and structures that are all required to facilitate the orderly operation of an economy.

Mr. Zwick also explained that financing infrastructure investments remains a challenge, but that there has been a precipitous drop-off in the amount of municipal financing available for new projects and the amount of unlisted infrastructure funds has become a much larger share. He cautioned, however, that public and private funding should not be considered mutually exclusive: On the municipal finance bond side, the primary risk is that it is driven more by the overall fiscal health of the government involved; if it is privately financed, the issue is more around the kind of the performance of the particular asset or the strength of the company supporting that particular project.

On the muni side, investors can take advantage of the tax benefit. On the privately financed side, that is not necessarily as attractive because the tax benefits are not so significant. On the muni side, most are double-A rated; on the privately financed side, to the extent they are rated, they tend to be more in a jumble, the A-minus/triple-B range. On the muni finance side, it's a diverse market, but it’s not necessarily idiosyncratic, so there’s a lot of different municipal bond issuers. Conversely, on the private finance side, every deal looks different.

New Business and Closing Remarks.

Before turning over the meeting to Deputy Director Seitz, Chairman Glaser thanked all of the presenters and participants.

Deputy Director Seitz also thanked the participants and recognized Chester McPherson for his work with FACI.

Chairman Glaser thanked everyone and mentioned that the next FACI meeting would be on Thursday, 17 August 2017.

At 4:40pm, Chairman Glaser concluded the meeting.