STATEMENT OF

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OF THE

UNITED STATES SENATE

ON

Perspectives on Modernizing Insurance Regulation

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Thank you, Chairman Dodd, Ranking Member Shelby, and members of the Committee. My name is Bill Berkley. I am the CEO of W.R. Berkley Corporation, a multi-billion dollar commercial lines property-casualty insurance and reinsurance group that I founded in 1967, which is headquartered, Mr. Chairman, in Greenwich, Connecticut. I am testifying today not just as CEO of W.R. Berkley, but as Chairman of the Board of the American Insurance Association. I appreciate the opportunity to be here to discuss issues of great importance during this time of economic upheaval and to participate in the important work of reshaping our regulatory landscape to confront future challenges and protect insureds.

I believe that I bring a unique and broad perspective to this discussion. I have been involved in the insurance business as an investor or manager for over 40 years. I am a leading shareholder of insurance companies that protect U.S. businesses of all sizes from the risk of loss and that provide reinsurance, but I am also a majority shareholder of a nationally chartered community bank. I have witnessed the ebbs and flows of business cycles during that time, with the only constants being the existence of risk and the need to manage it. It is that challenge that brings us here today – the imperative of examining, understanding and measuring risk on an individual and systemic level – and retooling the financial regulatory structure to be responsive to that risk, recognizing that you cannot forecast every problem.

With that context in mind, I would like to focus my remarks today on three major themes:

1. Property-casualty insurance is critical to our economy, but it does not pose the same types of systemic risk challenges as most other financial services sectors.
2. Nonetheless, because property-casualty insurance is so essential to the functioning of the economy and is especially critical in times of crisis and catastrophe, functional federal insurance regulation will enhance the industry's effectiveness and thus should be included as part of any well-constructed federal program to analyze, manage and minimize systemic risk.
3. Given the national and global nature of risk assumed by property and casualty insurers, establishment of an independent federal insurance regulator is the only effective way of including property-casualty insurance in such a program.

Property-casualty insurance is essential to the overall well-being of the U.S. economy. Insurance contributes 2.4% to the annual GDP, with property-casualty insurance accounting for more than $535 billion in capital, purchasing close to $370 billion in state and municipal bonds, paying almost $250 billion annually in claims and, importantly, directly or indirectly employing 1.5 million hard-working Americans. Because property-casualty insurance protects individuals and businesses against unforeseen risks and enables them to meet financial demands in the face of adversity, it is the engine that propels commerce and innovation. Without the critical coverage provided by property-casualty insurance, capital markets would grind to a halt: Main Street and large businesses alike.

While property-casualty insurance plays an essential role in our economy, it has been successfully weathering the current crisis. It has had to carefully navigate through some heavy turbulence to do so, but the sector remains strong overall, today. There are several reasons for that, but importantly property-casualty insurance operations are generally low-leveraged businesses, with lower asset-to-capital ratios than other financial institutions, more conservative investment portfolios, and more predictable cash outflows that are tied to insurance claims rather than "on-demand" access to assets.

Yet, despite the industry's relative stability in this crisis, there are compelling reasons to establish federal functional regulation for property-casualty insurance in any regulatory overhaul plans even though it has not presented systemic risk. The industry could always face huge, unforeseen, multi-billion dollar loss events such as a widespread natural disaster or another terrorist attack on U.S. soil. It makes little sense to look at national insurance regulation <u>after</u> the event has already occurred, but all the sense in the world to put such a structure in place to help either avoid the consequences of an unforeseen event altogether or to temper them through appropriate federal mechanisms, ultimately minimizing potential industry disruption.

However this Committee resolves the debate on federal systemic risk oversight, the only effective way to include property-casualty insurance would be to create an independent federal functional insurance regulator that stands as an equal to the other federal banking and securities regulators.

I continue to believe this after much deliberation and with great respect for the state insurance regulatory community. The state-based insurance regulatory structure is inevitably fragmented and frequently not well-equipped to close the regulatory gaps that the current crisis has exposed. Each state only has jurisdiction to address those companies under its regulatory control, and only to the extent of that control. Even where the states have identical insurance codes or regulations, the regulatory outcomes may still be inconsistent because of diverse political environments and regulatory interests. If this crisis has revealed anything, it is the need for more – not less – regulatory efficiency, coordinated activity or tracking, sophisticated analysis of market trends and the ability to anticipate and deal with potential systemic risk before the crisis is at hand.

In addition, virtually all foreign countries have national regulators who recognize that industry supervision goes well beyond a focus on solvency. Effective contemporary regulation also must examine erratic market behavior by companies in competitive markets to ensure that those markets continue to function properly and do not either encourage other competitors to follow the lead of irrational actors or impede the competitive ability of well-managed enterprises. Further, the U.S. Constitution prevents the states from exercising the foreign affairs and foreign commerce powers. Therefore, if we are to coordinate with other nations and their financial regulators to address global crises like the current one, we need a single insurance voice at the federal level to do so.

In sharing these observations, I want to be clear: This is not a criticism of state regulators; it is a conclusion about the inevitable limitations and gaps inherent in separate state regulation from one who has been in the business for decades.

Equally important, functional federal insurance regulation allows a single agency to be well-informed about all of the activities within the insurance sector, including those types of unforeseen mega-events that could affect other sectors of the economy. It also provides the foundation for equitable regulatory action in times of crisis and when the insurance sector is functioning normally. As even-handed as every state regulator may try to be, without the broadest responsibility exercised by a national regulator, we cannot expect to get that treatment where issues affect more than one state. The reality is that no one state can effectively deal with mega-events or cross-border issues equally, and among multiple states, the ability to deal with such events or issues on a global level declines dramatically.

A centralized regulator at the federal level would also have authority to examine the related issue of mathematical models. The methods of examining and measuring risk have undergone significant evolution during my 40-plus years in the insurance business. I believe there has been a growing and unhealthy over-reliance on numbers-driven models in the assumption of risk, and to the use of these models to the exclusion of common sense and underwriting experience. Although such models have an important role in insurance like they do in other financial services industries, risk evaluation and management inevitably suffer where such models are used in a vacuum.

The AIA and its members have long supported the National Insurance Act sponsored by Senator Johnson as the right vehicle for smarter, more effective functional federal insurance regulation. That bill already focuses on safety and soundness supervision, financial regulation, and rigorous market conduct oversight as core consumer protections. It even requires the national insurance commissioner to conduct an enterprise-wide review of financial data when examining national insurers. This - in and of itself - importantly distinguishes the National Insurance Act from current state regulation.

Yet, we recognize that even the best legislative vehicle must be updated to be responsive to the evolving economic climate and to enhance strong consumer protections. As a result, we support amending the legislation to prevent even the theoretical ability of insurers to “arbitrage” the federal and state regulatory systems by switching back-and-forth to try and escape enforcement actions.

Let me close by thanking the Committee again for opening the dialogue on this critical subject. The time is ripe for thoughtful, measured, but decisive action. We stand ready to work with you on a regulatory system that restores confidence in our financial system.