CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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Attention: Center for Insurance Policy and Research,
Capital Markets Bureau
National Association of Insurance Commissioners
444 North Capitol Street NW, Suite 700
Washington, DC 20001

Re: Request for Information on the U.S. Insurance Industry and Infrastructure Investments

The U.S. Chamber of Commerce's ("the Chamber") appreciates the opportunity to comment on the Request for Information ("RFI") from the Center for Insurance Policy and Research (CIPR) and the Capital Markets Bureau (CMB) at the National Association of Insurance Commissioners (NAIC) regarding a research study aimed at discussing and clarifying topics surrounding infrastructure investments and determining the role of U.S. insurance companies as a source of infrastructure financing. Our letter comments on each of the topics raised in the RFI:

I. Definition of "Infrastructure"
II. The Investment Characteristics of Infrastructure
III. The Market Size for Infrastructure Assets
IV. The Credit Performance of Infrastructure Investments as an Asset Class
V. The NAIC Treatment of Infrastructure Assets
VI. The U.S. Insurance Industry's Exposure to Infrastructure Investments
VII. The Role of Insurance as an Element of Climate Resiliency for Infrastructure

Role of Insurance Industry in Infrastructure Investment

The U.S. Chamber of Commerce believes it is critical for the United States to modernize its infrastructure and commends the NAIC on its research initiative. Most Americans agree that our roads, bridges, mass transit systems, air and sea ports, and water infrastructure are critical national assets that drive growth, jobs, safety, and global competitiveness. However, we cannot seem to agree on how to pay for badly needed repairs and maintenance. As we debate over infrastructure funding, America's roads, highways and bridges continue to deteriorate, while the public and small businesses pay the price. The insurance industry already provides significant funding in support of America's infrastructure and is positioned to contribute more capital.

Earlier this year, the Chamber released a report studying how the insurance industry invests in the U.S. economy.[1] The report examines the business model of insurance companies, studies their investment strategies, analyzes their significance in the market as institutional investors, and explores how their investment is manifest in the U.S. economy.

Insurance companies invest in a unique set of assets as a direct result of their business model. The basic business model of an insurance company involves receiving a steady cash inflow from policyholders in the form of premiums that, over time, are allocated internally and flow to operating expenses, new investment assets, and payouts for claims. Thus, policyholder premiums are used, in part, to invest in assets that generate returns, which ultimately are used to pay future claims.

With both life and P&C insurance companies facing predictable liabilities over a long duration, their investments are focused on assets that can effectively pay for future liabilities for the entire duration of the policies provided by the company. Investment strategies are centered on four key criteria:

1. Duration matching. Assets need to match projected liabilities for insurance companies, which means investments are typically longer-term.
2. Low credit risk. Insurance investments are focused on managing credit risk. Many insurance companies invest in alternative asset types, but these investments are often structured to limit credit risk exposure.
3. Diversification. Insurance companies want to build a diverse portfolio that includes a variety of asset types, levels of liquidity, and sectors of focus.
4. Optimize capital redeployment. As a result of the business need for long-term returns, insurance companies are required to hold capital against their investment portfolio. In terms of investment strategy, capital requirements limit investment in more volatile products. This leads companies to focus on fixed-income products instead of equity.

Most insurance companies focus on investment-grade assets and use their ability to provide long-term liquidity to markets as a means of accessing excess yield. Insurance companies are ideal partners, as they are able to provide liquidity in

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[1] U.S. Chamber of Commerce. The Role of Insurance Investments in the U.S. Economy (Winter 2019), available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/03/CCMC_InsurancePaper_v2.pdf

exchange for long-term illiquid assets, allowing them to capture a liquidity premium. This investment strategy has been important given the low interest rate environment, as insurance companies are no longer able to access sufficient yield through the public bond markets, traditionally the most popular asset class for insurers.

I. Definition of "Infrastructure"

As noted in the RFI, a universal or standard definition for infrastructure investments is not available, and market participants may have different views of which assets are considered infrastructure. The Chamber defines infrastructure as our transportation network, drinking water, stormwater, and wastewater systems, green infrastructure, transmission grid and pipelines, and rural broadband. However, we recognize the insurance industry may be interested in investing in other assets that meet their criteria for duration matching, low credit risk, diversification, and optimizing capital redeployment.

There are other assets invested in by insurance companies that may not conform to a strict definition of "infrastructure" but that have the same characteristics as those that fall within the definition. Social infrastructure (e.g., schools, hospitals, courthouses, and low income multi-family housing.) are oftentimes desirable investments for insurance firms. These assets are also an ideal opportunity for the industry to help achieve important social goals.

For example, according to analysis from Chamber, the municipal bond purchase of the U.S. insurance industry could build about 350 high schools or 1,000 elementary schools every year.[2]

a. Economic Infrastructure

The NAIC has developed a definition for "economic infrastructure" as an initial step in this research project. The NAIC defines economic infrastructure as "Long-lived, capital intensive, large physical assets that provide essential services or facilities to a country, state, municipality, or region and contributes to its economic development or prosperity."[3] The Chamber does not disagree with this definition, and believes it is commendable attempt to define infrastructure; however, we believe

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[2] U.S. Chamber of Commerce. The Role of Insurance Investments in the U.S. Economy (Winter 2019), available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/03/CCMC_InsurancePaper_v2.pdf

[3] NAIC/CIPR Infrastructure Investments Study. (2019, October). Request for Information – Infrastructure Definition Observations.

certain assets are being excluded without appropriate explanation. The Chamber believes "rolling stock" and "parking structures and meters," should be included in the definition – it is unclear why they were expressly excluded given the characteristics of the assets.

b. Social Infrastructure

The Chamber strongly recommends that the NAIC include "social infrastructure" in the research study. The Chamber does not oppose bifurcating the definitions for "economic" and "social" infrastructure but believes the latter merits study by the NAIC, especially given the significance of the insurance industry in this market.

The examples of "social infrastructure" provided by the NAIC meet its key characteristics of infrastructure investments. The NAIC states these characteristics are: large physical assets, long operational life, capital intensive, essential need, and not easily duplicated. Many, if not all, of the examples of "social infrastructure" provided by the NAIC appear to meet most, if not all, of the criteria of the broader definition of "infrastructure." Therefore, it is unclear why social infrastructure would be excluded from the study. The question of "essential need" raised during the NAIC's conference call merits further discussion.

It was suggested that the capital needs for "social infrastructure" are largely already being met by the market and public sources of funding. The Chamber believes that "economic infrastructure" should be a public policy priority given its severe funding shortage, but strongly disagrees with the assessment that "social infrastructure" is receiving sufficient funding. We are not aware of any holistic studies that reach this conclusion; however, there is strong evidence that, for example, that the United States is entering/has entered a period where there is a shortage of affordable housing.

The U.S. insurance industry invests in assets that support the construction of housing in a number of ways. Insurers not only make loans and investments for conventional multifamily housing, but also support thousands of units dedicated to low-income, workforce, senior, and disabled households every year. They provide direct private financing and investments and participate in government-affiliated programs such as Fannie Mae, Freddie Mac, the Department of Housing and Urban Development's FHA and Community Development, initiatives from the Department of Veterans Affairs, and state and local affordable programs and bonds, among others.

Finally, on the question of "essential need," it should be noted that an increase in the supply of capital in the market (shifting the supply curve outward) would decrease financing costs. Therefore, the insurance industry can decrease the cost of establishing social infrastructure even if there are other established funding sources.

II. The Investment Characteristics of Infrastructure

The Chamber believes the investment characteristics of infrastructure are aligned with the investment criteria of insurance companies. In general, infrastructure assets are low-risk and long-term in nature making them a suitable investment to match the liabilities of the insurance industry.

For equity, it is possible to differentiate private equity funds depending on whether the fund solely invests in infrastructure or it is a broad category fund that includes infrastructure.

III. The Market Size for Infrastructure Assets

The market size for "infrastructure assets" will depend on the parameters set by the NAIC for conducting its research. Primarily, it will depend on the NAIC's definition and the types of assets this will include. Determining the market for each asset type will depend on how specific definitions are interpreted in order to categorize the transactions.

One asset type that should be included when determining the market size for infrastructure investment is municipal debt. The traditional method of investing in infrastructure through municipal bonds continues to play a major role for insurance companies. The long-term holding nature of insurance companies aligns well with the long-term financing needs of government entities. The insurance industry's presence provides stability, efficiency, and a recurring demand source in the market. Here, insurance companies are the fourth leading source of capital after individual investors, mutual funds, and banks. According to analysis by the U.S. Chamber of Commerce, insurers own approximately 20 percent of all municipal debt.

Municipal debt is used to fund investment in both economic infrastructure and social infrastructure. For example, U.S. insurance investments in education projects through municipal bond purchases could build about 1,000 elementary schools every year. Likewise, their annual investments in municipal bonds used for transportation projects could build a road from Washington, D.C., to Los Angeles every year.

Demand for municipal bonds has kept up with previous years as they continue to provide low credit risk and strong relative yields. Investments in municipal bonds from insurance companies grew 1.7% to $745 billion in 2017, with market participants expecting a similar or fractionally smaller level of investment going forward. Municipal bonds are also seen as good investments for diversification purposes.

P&C companies' ability to take advantage of tax-exempt assets has led to a higher allocation to municipal securities. The tax-exempt nature of municipal bonds provides three financial benefits for P&C companies: the reduced (or exempt) tax obligation on interest generated means that P&C companies have lower tax bills and can worry less about managing their income stream to manage the potential tax obligations. The tax-exempt nature of municipal bonds also allows P&C companies to capture yields that would otherwise be lower on taxable corporate bonds of a similar credit risk. Finally, the less-predictable nature of P&C obligations requires more active asset turnover to manage claims. Without the exempt status, the tax obligations generated by higher transaction activity to satisfy these claims would impact profitability. The Tax Cuts and Jobs Act of 2017 has adjusted these benefits.

The profile of direct infrastructure investments makes them ideal for private-sector investors with long-term horizons and large capital bases. These investments require sophisticated knowledge and expertise from investors that allow them to navigate a complex risk-return asset profile across the life cycle (from planning to construction to wind-down). As of 2017, global insurance companies had allocated over $1 trillion in direct infrastructure projects, and participants expect this allocation to increase as insurance companies look to achieve their target asset allocation.[4]

IV. The Credit Performance of Infrastructure Investments as an Asset Class

The Chamber appreciates the NAIC's recognition that credit performance on infrastructure assets varies based on numerous criteria. We would recommend considering historical default data as reliable evidence for the credit performance of infrastructure investments. However, the default performance of a single loan is not comparable to cohort-based average default statistics; again, we believe a more granular analysis would be informative for understanding the investment characteristics of different infrastructure assets.

[4] TIAA, 2017, "Building Roads to the Future"

V. The NAIC Treatment of Infrastructure Assets

The regulatory treatment of infrastructure assets can be an impediment to investment. As noted above, there are a number of factors that drive infrastructure investment, but regulatory considerations for the NAIC's treatment of infrastructure assets that influence the cost of capital are also significant.

The Chamber believes the NAIC should amend its risk-based capital framework so it does not discourage further investment into infrastructure projects. The amendments to the risk-based capital framework should recognize that infrastructure assets are, on-average, relatively low risk and the investments are well-aligned with the business model of the insurance industry. The amendments should also recognize that the investments each have a different risk depending on the terms of the financing, the asset it supports, etc. The Chamber believes updates to the NAIC's risk-based capital framework could permit for investment in updating the nation's infrastructure without undermining the solvency of insurance firms.

VI. The U.S. Insurance Industry's Exposure to Infrastructure Investments

The Chamber recognizes the challenge in determining the U.S. insurance industry's exposure to infrastructure investment. We believe that standard definitions will help with quantifying this information. The RFI also raises the question of whether the credit performance of insurance industry exposure is different than the market – we see no reason to reach this conclusion.

VII. The Role of Insurance as an Element of Climate Resiliency for Infrastructure

The Chamber strongly believes that infrastructure should incorporate resiliency and maintenance into its criteria considerations. Infrastructure is a long-term investment that will require pre-disaster mitigation in order to reduce loss or damage risks and prolong the life of the investment. Building resilience into infrastructure, both the physical systems such as water and sanitation and electricity, and the social systems such as health care, emergency response means increasing the capacity of these systems to absorb shocks and continue to function when they are disrupted. In fact, the Chamber Business Task Force on Water Policy has identified resilience as a top priority.[5]

[5] The U.S. Chamber launched the Business Task Force on Water Policy during August 2018. The group is comprised of member companies, state and local chambers, and other associations.

Currently, more than 87% of funding is spent on post-disaster event response, recovery, and relief. Twenty-five percent of small businesses impacted by a natural disaster never reopen. More must be done to catalyze planning and investing ahead of the next disaster — whether drought, floods, wildfires, and other extreme whether events.

There is data demonstrating that for every $1 invested in pre-disaster projects, between $4 and $6 in benefits are achieved. Much of the advantages are in reducing risks for investors and building long-term, sustainable assets. To that end, we believe it is appropriate for insurers to consider pre-disaster mitigation as part of any infrastructure investment underwriting and development.

Congress passed the Disaster Response Reform Act as part of the Federal Aviation Administration Reauthorization Act of 2018, which was signed into law on October 5, 2018. The law will place 6% of annual disaster spending into a new national public infrastructure Pre-disaster Mitigation fund that could provide as much as $1 billion in risk-reducing pre-disaster assistance annually. This new FEMA Building Resilient Infrastructure and Communities Program will provide funding to states based on state mitigation plans to modernize infrastructure, not just building back the way it was in the past. Such pre-disaster focus will make it more likely for insurers to invest in infrastructure assets that are building to reduce future risk of losses.

Closing

The Chamber supports this initiative by the NAIC. We believe the research report can help contribute to a more informed dialogue for how insurance policy affects our capital markets, especially infrastructure investment. Furthermore, we strongly urge the NAIC to consider reducing the risk-based capital charge for infrastructure investments to incentivize increased insurer participation in the space. We look forward to the publication of the research paper in 2020 and we hope the NAIC will consider policy changes that reflect its findings regarding the insurance industry's investment in infrastructure.

Very Respectfully,

Tom Quaadman