Testimony before

Subcommittee on Trade of the

Committee on Ways and Means

Charles D. Lake II

Chairman, Aflac Japan

Washington, D.C.

September 20, 2012

Introduction

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of Aflac to discuss the benefits of expanding U.S. services trade through an International Services Agreement. My name is Charles Lake. I am Chairman of Aflac Japan.

Japan has significant relevance to the issue at hand as the world's 2nd largest life insurance market. It is second only to the U.S. and generates approximately $390 billion in annual premiums. Moreover, U.S. companies have done well in this market and currently account for over 12 percent in terms of premium income. These statistics demonstrate that the Japanese life insurance market is extremely important for U.S. insurers in-and-of-itself as a market. Beyond this fact, given that the Japanese insurance market constitutes nearly 20 percent of the global insurance market in terms of gross premiums, precedents set in Japan have regional and global ramifications.

The views that I express here today reflect my experience, not only as a businessman, but also as a former practicing attorney and as an official at the Office of the U.S. Trade Representative (USTR) who took part in the negotiations of the General Agreement on Trade in Services (GATS) under the World Trade Organization (WTO). In addition, I currently serve as the Chairman of the U.S.-Japan Business Council and the International Committee of the American Council of Life Insurers (ACLI) — roles that provide insight into issues that confront the broader business community and that go beyond the specific scope of Aflac.

I am sure that many of you are familiar with Aflac through its U.S. operations and of course the Aflac duck. Aflac is a major employer in the states of Georgia, Nebraska, South Carolina, and New York, and Aflac's more than 75,000 agents sell the Company's products to customers throughout the United States. We continue to add jobs to the economy.

What you may not know is that Aflac is a leading U.S. exporter of services. Aflac entered the Japanese market in 1974 as a branch of its U.S. insurance company now domiciled in the State of Nebraska. Thanks to the strategic vision and over twenty years of leadership by our global CEO Dan Amos, Aflac has been very successful in Japan, generating $18.4 billion in revenues in 2011 in that market. Indeed, Aflac is a great example of how American companies can, and do, succeed in Japan. We have found Japanese people to be extremely fair, willing to buy products from and work as business partners with companies like Aflac that offer the best products with the best value that meet the needs of Japanese customers. As a result, Aflac has become the number one life insurer in Japan in terms of individual insurance policies in-force, reaching a total of 22 million policies in force as of June 2012.

The Company's investment in Japan goes much deeper than providing top-quality products and services to our customers. Aflac is fully committed to creating and sustaining a work environment in which our employees can grow and perform at their very best and to participating actively as a good corporate citizen in Japan. Whether it's contributing to the Aflac Cancer and Blood Disorders Center in Atlanta or the Aflac Parents Houses in Japan, Aflac is a vital part of local communities in both the U.S. and Japan. In fact, even as we speak, Dan Amos is in Japan to announce the launching of the Tomodachi-Aflac Japan Medical Fellows Program in partnership with the Tomodachi Initiative, a public-private partnership founded in the wake of the Great East Japan Earthquake.

Through this program, Aflac is sending promising Japanese pediatric oncologists primarily from the areas devastated by the earthquake and tsunami for study at the Aflac Cancer Center in Atlanta, Georgia. The intent is to share best practices and the latest treatments and techniques with the next generation of medical practitioners from Japan.

<u>Tackling 21st Century Issues in the Post Global Financial Crisis World</u>

Aflac's success outside the U.S. market gives us deep insights into what it takes to be an effective international company running an operation in a foreign country. We strongly believe that we can compete effectively with any company as long as there is a level playing field. We do not seek special advantages from our Government as we compete with Japanese companies. But to ensure that the playing field is level, U.S. Government engagement is frequently necessary to combat protectionist measures designed to favor politically influential domestic players. Accordingly, we believe that it is essential that the United States continue to rigorously enforce existing trade agreements as well as lead the effort to craft a WTO-plus International Services Agreement which is comprehensive in sectoral scope and addresses head-on the growing array of "beyond the border" barriers that increasingly inhibit business activity.

The importance of undertaking an energetic effort to negotiate a WTO-plus International Services Agreement is made even more important by the fact that an enormous effort is underway to establish new international financial standards that will have significant competitive impact on the business environment. In this context, the United States must continue to pursue a coherent and integrated strategic approach to engaging international financial standards-setting bodies on the one hand and in building a stronger trade and investment architecture under the WTO on the other.

To further elaborate on this point, I would like to first discuss how countries are responding to the lessons learned in the post global financial crisis world. Second, I would like to highlight some important policy questions raised by the fact that international standards-setting bodies are taking an activist approach to developing standards that affect the competitive environment. Third, I would like to discuss the unique challenge posed by the increasingly dominant role of state-owned enterprises.

The Enhanced and Increasingly Activist Role of International Standards-Setting Bodies

Following the impact of the financial crisis and Lehman shock, efforts to create new international rules and standards setting for the 21st century began at the first Group of Twenty or G20 Summit on Financial Markets and the World Economy in Washington in 2008. At that time, individual countries were taking urgent measures to stimulate their economies and stabilize their financial markets. As well as working at the national level, leaders saw the need to cooperate at the international level in order to restore global growth and implement needed reforms in the world's financial system. We firmly support efforts at the G20 in this regard and fully agree with the maxim that a "global crisis requires global solutions."

Leaders put together an action plan for reform that included actions to strengthen transparency and accountability and enhance sound regulation. In their declaration, the G20 leaders recognized that the reforms would only be successful if grounded in a commitment to free market principles, including open trade and investment, competitive markets, and efficient, effectively regulated financial systems.

Today, as the G20 and the Financial Stability Board (FSB) continue their efforts to strengthen the global economic and financial regulatory architecture, substantial progress is being made in the priority reform areas such as the Basel capital and liquidity requirements, the framework for globally systemically important financial institutions (GSIFIs), resolution regimes, over-the-counter (OTC) derivatives reforms, shadow banking, and compensation practices. In the insurance area, the G20 has tasked the FSB in consultation with the International Association of Insurance Supervisors (IAIS) (the international insurance standard-setting body) to complete their work on identification of and policy measures for global systemically important insurers by April 2013. In addition, the IAIS adopted a new set of Insurance Core Principles (ICPs) in late 2011 and is undertaking a major effort to develop a comprehensive framework and methods to address regulatory and risk issues involved in group-wide supervision of so-called Internationally Active Insurance Groups (IAIG).

As this enormous effort continues, companies are being confronted by a number of new and old challenges. These challenges include, for example, adjusting business models to meet the requirements of the new global financial regulations as well as confronting new forms of protectionism that have emerged since the crisis. Business leaders and policymakers must work together to find ways to address these 21st century challenges that hold the key to unlocking substantial growth and prosperity in the future.

Balancing the Important Work of International Institutions with the Respect for the Authority of Democratically-Elected Legislatures

I would like to take a moment to highlight a couple of specific policy issues, particularly based on my experience as a former international trade negotiator and as an executive on the ground in Tokyo. One such issue is the necessity to strike a delicate balance between the critical need to make progress in the work of international standard-setting bodies on the one hand and ensure that the authority of duly-elected national and state legislatures is fully respected on the other. Care must be taken to ensure that the very important work of strengthening the global economic and financial regulatory architecture is not misused by global bureaucrats to distort the competitive field in favor of domestic champions from their home countries.

International organizations fundamentally are defined by the legal authority that their member governments grant them through treaty, or through commitments to undertake domestic implementing measures. The World Trade Organization (WTO) or the International Monetary Fund (IMF), for example, are international organizations whose scope of authority has been established by sovereign member countries entering into binding treaties or other agreements formally ratified and enacted by their governments. These agreements contain clear, legally-binding rights and responsibilities. The member countries, as sovereign states, agreed to forgo their freedom to act in certain circumstances, committing formally to comply with a structure with binding rules and consequences. This is one reason why this Subcommittee has been very active in exercising its constitutionally mandated oversight of the Executive Branch regarding its engagement in international negotiations such as the WTO Doha Round and the Trans-Pacific Partnership negotiations.

In contrast to the WTO or IMF, other international institutions such as the G20 or the International Association of Insurance Supervisors (IAIS), for example, have been established, not through formal, ratified treaties, but through the political commitments of their respective leaders. Because such institutions lack formal treaties in which member countries granted specific authorities, as a matter of international law, the scope of their activities must be limited by the existing authority of their member countries' executive branches. Anything beyond that scope would require additional legislative action at the national level. Given the complexity of having to deal with legislative and policy processes in the various member countries, changes in this arena must by necessity be evolutionary and not revolutionary.

However, in the rush to respond to the daunting challenges created by the global financial crisis and now the ongoing situation in Europe, it is easy for these institutions to overstep these limits, possibly crossing over into territory best occupied by duly-elected legislators or, at a minimum, by regulators and other government officials who are accountable to such elected legislators. For example, in late 2011, the IAIS undertook an ongoing workstream to review the supervisory practices among insurance supervisors with regard to how foreign branches are supervised in different jurisdictions around the world. From the very beginning the workstream appeared to be agenda-driven with apparent bias against foreign branches. Even though statistical analysis regarding the soundness of branches relative to mutual or stock companies has yet to be conducted, the IAIS workstream appears to be headed in the direction of establishing principles that would grant local authorities the right to force insurance companies to convert their branches into locally-incorporated subsidiaries.

This trend is inconsistent with the fact that the governments of many IAIS members have made legally binding commitments to abide by the WTO General Agreement on Trade in Services or the GATS as well as the OECD Code of Liberalization of Current Invisible Operations ("OECD Code"), which both strongly protect the ability to operate through branches. GATS Article XVI (2) prohibits any government measure which "restricts or requires" the form of legal entity — e.g., foreign branch, subsidiary — through which a GATS member supplies a service in the territory of another member. The OECD Code meanwhile requires member countries to "ensure equivalent treatment for national insurers and insurers from other Members so that the latter shall not be liable to heavier burdens than those imposed on national insurers."[1] It is possible that if this workstream were to continue along its current path, the IAIS could ultimately set standards that are inconsistent with duly-enacted U.S. laws.

More specifically in the Japan context, we are starting to see troubling signs in relation to this issue. Japan's Financial Services Agency or FSA recently released its "Annual Supervisory Objectives for Insurance Companies, etc. for Program Year 2012" which covers July 2012 through June 2013. This document sets forth the FSA's top supervisory priorities for insurance companies for the coming year. In it, the FSA states that foreign branches:

---

1 Both the GATS and the OECD Code permit member countries to take measures "for prudential reasons." However, under the GATS, prudential reasons cannot be used as a "means of avoiding the Members' commitment or obligations." Similarly, the OECD Code limits the scope of "prudential considerations" by incorporating the following provision with respect to insurance and private pensions:

> *Prudential considerations*.
> *Members may take regulatory measures in the field of insurance and pensions, including the regulation of promotion, in order to protect the interests of policyholders and beneficiaries, provided that those measures do not discriminate against non-resident providers of such services*.

> ***are directly or indirectly subordinate to foreign headquarters and holding companies that are not subject to Japanese laws and regulations, etc., and the management/control methods, etc., of some [of these foreign headquarters and holding companies] cause a risk that overall control in their Japan operation may not function fully and properly.*** *Therefore, it is important for their Japan operation to be granted sufficient authority and responsibility whereby it can establish internal control and management control systems in Japan with a clear decision-making process* ***(depending on the size and business content of the Japan operation, it is appropriate to incorporate branches as local subsidiaries of foreign insurance companies).*** (Emphasis added)

I have been living on the ground in Tokyo now for thirteen years and have had a great working relationship with Japan's FSA during this time. I consider many of its officials my personal friends as I have known them for more than 20 years, thanks to the relationships we formed when I served as the Director of Japan Affairs at USTR. Thus, I know based on my own experience that Japan's FSA is a sophisticated world-class regulator. However, despite this fact, the current global environment and the speed to which regulators must develop and implement new regulatory standards in response to the G20, FSB, and IAIS agenda can lead to supervisory policy statements, such as this one, that appear to be at odds with legally-binding commitments that its government made at the WTO and the OECD.

I am optimistic that this issue will be ultimately resolved in a manner consistent with sound regulation and compliance with Japan's international obligations. If it were not, it could set a precedent allowing foreign governments to use the IAIS process to effectively renegotiate their international trade commitments. Today, I provide this issue as an example of the type of issues that confront the industry and that require a careful watch by this Subcommittee and relevant government agencies.

The Challenge Posed by State-Owned Enterprises

Another major challenge facing U.S. services companies more generally is that posed by state-owned enterprises or SOEs. There is a tendency for people to think that state capitalism is mostly an issue for companies operating in China, and certainly the rise of China is fuelling an increase in the power and influence of state-owned enterprises.

However, businesses can also find the playing field skewed in favor of state-owned or supported enterprises in democracies such as Korea, Brazil, India, and also in Japan. In Japan, an increasingly important challenge for foreign and domestic companies is the need to compete with a huge, government-owned, controlled, and favored insurance company — Japan Post Insurance. Japan Post Insurance is the largest insurance company in the world and, along with Japan Post Bank, is part of the world's largest financial institution. It holds nearly a third of all assets in the industry, worth 96.8 trillion yen, and received 7.3 trillion in premium income in 2010 — approximately a quarter of the industry total.

Unlike the trade friction years of the 1980s and 1990s, what makes this issue unique is that there is total consensus between the private sector companies from Japan, the United States, Europe and Canada that a level playing field must be established between private insurance companies and Japan Post. To this end, the Life Insurance Association of Japan (LIAJ) and eight other banking industry associations in Japan have issued statements calling for a level playing field just as the ACLI, the Coalition of Services Industries (CSI) and other U.S. trade associations have done.

In my view, the challenge the private sector faces is not only in the domestic regulatory environment where Japan Post receives different and more lax regulation and oversight, but also in the favorable treatment of Japan Post with regard to international standards and global best practices. For example, the IAIS recently revised its Insurance Core Principles, which provide a globally-accepted framework for the supervision of the insurance sector and is intended to apply to insurance supervision in all jurisdictions regardless of the level of development or sophistication of the insurance markets and the type of insurance products or services being supervised.

Despite the fact that the IAIS has explicitly set forth that the Insurance Core Principles are intended for all insurance companies in all jurisdictions, including for SOEs, in many cases SOEs are not subject to the same level of scrutiny regarding their compliance with the principles as private sector companies. State-owned insurers compete with private insurance suppliers, and because the state-owned companies are often "national champions," they enjoy special privileges beyond more lax regulation, which distorts the competitive environment.

Given their size and role in the market, policymakers will be unable to properly reform the global regulatory system and ensure the strength of the international financial system if state-owned enterprises, some of the world's largest and systemically important financial institutions, are not subject to the same international regulatory oversight and domestic enforcement as their private sector counterparts.

State-Owned Insurers Are Often Overlooked by the International Regulatory Regime

Looking at the practical application of supervisory standards, where the rubber hits the road, the IMF and World Bank use IAIS Insurance Core Principles as the metric for conducting audits of national regulatory and supervisory systems for insurance pursuant to the Financial Sector Assessment Program (FSAP). These audits are a cornerstone of the FSB's efforts to ensure global financial stability by providing meaningful information to policymakers. They can have a substantial impact on the enactment of legislation and regulations in subject countries, and represent an important tool for reform.

But I must point out that when the IMF or World Bank conducts an FSAP — whose stated aim is to apply IAIS standards in examining national insurance markets — countries can avoid the IAIS prescriptions by excluding certain insurance providers from stress tests and other forms of scrutiny on the grounds that they are subject to different regulatory schemes than ordinary private insurers.

For example, in the IMF's 2012 FSAP review of Japan, Japan Post Insurance was exempted from the stress test applied to other FSA-supervised insurance companies. The omission of such a major insurer from full FSAP review highlights the disconnect between IAIS standards and the way they are being applied in FSAP audits and reported back to policymakers.

To develop a sense of the scope of this problem, the ACLI has suggested that IAIS consider a thematic review and ask all of its members to report any insurance supplier that is not within the scope of the domestic insurance regulatory authority and, therefore, is able to slip away from international scrutiny. As emerging economies with state-capitalist tendencies play a bigger and more important role in the global financial system, in addition to distorting competition in the market place, the massive hole in the global financial services regulatory architecture could potentially provide a major source of systemic risk.

There are many state-owned life insurance companies operating in Asia. Examples of other major players include China Life Insurance (Group), the Life Insurance Corporation of India, and Korea Post Insurance. These entities are frequently supervised and regulated in a more lenient manner than private companies. Reflecting on lax supervision, they may or may not maintain internal controls and risk management systems comparable to those of private insurance suppliers. In other words, they sometimes operate in supervisory blind spots and represent risks to the financial system of unknown dimensions. Efforts to ensure a stable global financial regulatory system and to deepen economic integration in a bid to bolster growth are, therefore, being undermined by the emergence of state capitalism in increasingly important economies.

In 2011, 106 SOEs were featured in the Fortune 500 list of the world's largest companies. Four of the top ten largest companies in the world are SOEs, three Chinese and the other Japan Post. With emerging economies in Asia experiencing rapid growth, they have become more integrated in the global trading system and, in turn, have become increasingly important players in the global economy.

For companies operating in the Asia-Pacific region, SOEs are proving to be a formidable force posing a serious threat to fair competition in the marketplace and providing challenges as the regional trade, investment and regulatory architecture evolves.

Conclusion

These and other challenges facing the U.S. insurance and other service industries point to a huge need for a robust WTO-plus International Services Agreement. There is no question that the G20, FSB, and IAIS must continue their important work to strengthen the global economic and financial regulatory architecture. But given that these efforts can also lead to dramatic changes in the competitive environment, due care must be exercised to ensure that the process is not distorted by others to achieve the protectionist goals of their respective member governments. To this end, a robust effort to negotiate a WTO-plus International Services Agreement can have a dramatic impact in preventing protectionism and in promoting fair and free trade in services. We need the "services bicycle" to get going and to move faster to increase the momentum.

However, for the ISA to have relevance and be an important component to the establishment of a 21st century trade and investment architecture, it will need to do more than repackage provisions in the WTO's General Agreement on Trade in Services and deal with 21st century issues such as regulatory coherence and SOEs, as well as building further on traditional market access and expansion issues. Given the immediacy of the challenges facing the industry, it is pertinent that negotiations move swiftly and in a transparent manner.

Additionally, as I have discussed, in this post-global financial crisis world, the role of international standard-setting bodies and other international institutions in shaping the global economic and regulatory environment in which U.S. companies operate will only grow. In this context, a coherent integrated strategic approach to engaging these international organizations and countries is absolutely necessary. This approach must build on the past excellence that has been the hallmark of the United States in its execution of external economic affairs and in its engagement at international economic institutions. Many around the world believe that the U.S. Government is one of the most effective leaders in these international fora in setting the agenda and in influencing the outcome through its sophisticated use of hard and soft power.

The United States must continue to do this by effectively managing the policy development process and by strategically incorporating into this coherent, integrated, strategic approach, key players in U.S. regulation and trade, such as the United States Trade Representative, the Departments of Treasury, State, and Commerce, as well as key players such as state regulators and the National Association of Insurance Commissioners and others. If we fail to do this, the United States may find itself just merely responding to the developments in the international standards-setting efforts with detrimental results on U.S. interests. Instead, the preferred outcome is that the United States plays a major leading role in the shaping of the global regulatory and trade architecture and in defending and advancing a level competitive playing field while ensuring sound prudential regulation. We in the industry stand ready to support this Subcommittee, the Executive Branch, and our State Governments to achieve a win-win outcome for the United States and our trading partners around the world.