

Sept. 6, 2017

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Review of the FSOC's Non-Banks Designation Process

Dear Secretary Mnuchin:

On behalf of the National Association of Insurance Commissioners (NAIC),¹ we write to provide comments relating to your review of the Financial Stability Oversight Council's (FSOC) designation and determination authorities under Section 113 of the Dodd-Frank Act pursuant to the Presidential Memorandum dated April 21, 2017. To be clear, insurance regulators are supportive of the FSOC's role as a systemic risk monitor, and as a forum for coordination and information exchange among financial regulators, more akin to a supervisory college that is utilized by regulators for large multinational insurance groups. Our participation over the years through our representative (currently Director Peter Hartt of the New Jersey Department of Banking and Insurance) has enabled us to further cultivate relationships with the federal financial regulatory community that have been helpful in discussing issues transcending the insurance sector. However, we have serious concerns with the FSOC non-banks designation process. We believe it requires significant reform, if not outright elimination, and the FSOC should employ alternative approaches in lieu of, or prior to, considering a firm-specific designation.

Flaws with Non-Bank Designations

Firm specific designations can have serious consequences. To quote the first state insurance regulator representative to the FSOC, John Huff, former President of the NAIC and former Director of the Missouri Department of Insurance:

“the designation of insurance companies...is a serious exercise, the result of which could have significant implications for 1) the stability of the financial system, 2) policyholders that may be disadvantaged to the benefit of financial counterparties, 3) the cost and availability of insurance products, and 4) the competitiveness of the insurance sector. It is critically important that these decisions are based on robust

¹ Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

analytics and a thorough understanding of the insurance business and insurance regulation.”²

These designations have subjected insurance firms to an unnecessary additional layer of supervision that is no more likely to adequately address any identified insurance-related risks than the existing regulatory framework, have potentially created competitive imbalances within the sector, and have the potential to subject the firm, the sector, and the financial system to a host of undefined and unintended consequences. Addressing systemic risk through firm-specific designation is neither “efficient, effective, [n]or appropriately tailored” and therefore inconsistent with the Administration’s Core Principles for financial regulation.

After more than seven years and three insurance company designations, we have witnessed first-hand the FSOC’s flawed approach to firm-specific designations. The designations of the insurance companies have not been the result of robust analytics. The FSOC’s consideration of the insurance business model and the efficacy of state insurance regulation has been particularly erroneous. As evidenced by the designation of Prudential and MetLife over the objections of both the independent member with insurance expertise and the state insurance regulator representative, these flaws have been exacerbated by a consistent disregard of the expertise of FSOC members who understand or regulate the sector. Both identified serious analytical and factual flaws in these designations. Flaws include the failure to credibly extrapolate identified concerns to threats to financial stability, applying a banking perspective to the potential withdrawability of insurance products, a misunderstanding of the nature of insurance company resolution, and a lack of appreciation for the tools at the disposal of state insurance regulators that address several of the apparent concerns. Indeed, with respect to the regulatory tools available to the states, the Council in its analyses all but assumed that “any decision a state regulator might make to be too little, too much, too soon or too late.”³ The analyses were not only “antithetical to a fundamental and seasoned understanding of the business of insurance,” but they also ignore the state regulatory system’s 150-year successful track record, including its role in helping the sector navigate the most recent financial crisis.⁴

In part, these infirmities are the product of a flawed Council structure. While the Council technically has three members with insurance expertise, only two are independent from other Council members (the independent member with insurance expertise and the state insurance commissioner) and only one is a voting member (the independent member). By comparison, 5 of the 10 voting members are regulators of banks or their holding companies (CFPB, FDIC, Federal Reserve, OCC, and NCUA), most of whom do not have responsibilities in the non-bank space and are unlikely to be focused on the protection of insurance consumers, the availability of insurance products, or competitive imbalance within insurance markets. Compounding the problem, the representative of the insurance sector’s primary regulators has been relegated to non-voting status.

² View of John Huff, former Director of the Missouri Department of Insurance, Financial Institutions, and Professional Registration, Designation of Prudential Financial Inc., September 19, 2013 at 4.

³ Amicus Curiae Brief of the National Association of Insurance Commissioners, *MetLife, Inc. v. Financial Stability Oversight Council*, August 22, 2016 at 22.

⁴ View of S. Roy Woodall, Jr., Independent Member having Insurance Expertise, Designation of Prudential Financial Inc., September 19, 2013 at p. 1.

We also have concerns with the FSOC's lack of robust inclusion of state insurance regulators in the non-bank designations process. While in recent years the FSOC has made efforts to formally consult with state insurance regulators throughout the non-bank designations process as required by the Dodd-Frank Act and the FSOC's own Non-bank Designations Rule and Guidance, the typical one-off nature of such consultations remains troubling. Our FSOC representative and his limited staff have been prohibited from sharing information with fellow insurance regulators and the NAIC relating to the discussions at the FSOC including any risks within specific firms or the sector. This prohibition is unique to state regulators and one that has not been placed on the federal members of the Council, who can enlist the resources and expertise of their entire agencies.

Finally, notwithstanding our disagreement with the FSOC's designation decisions, we are troubled by the lack of clarity provided to regulators and the companies themselves on the specific issues of concern that led to these companies' designation. This approach ultimately fails to make the financial system safer because regulators and the company have little information on how to address the company's purported risk to the system. The failure to set forth a clear rationale as to the reasons for designation and to provide an "exit ramp" for designated firms is a fundamental flaw with the non-bank designation process that contributes to rather than reduces risks to the financial system. Labelling a firm systemic, applying an additional "SIFI surcharge," and requiring it to file a resolution plan creates a false sense of security that will not meaningfully change a firm's risk profile in the absence of further action to reduce or eliminate any areas of concern. In fact, former North Dakota Insurance Commissioner and former state regulator representative to the FSOC, Adam Hamm, in his dissent to the MetLife designation noted "it is unclear from the Basis what additional tools beyond those already at an insurance regulator's disposal could effectively address the risks the Council identifies, which are, in large part, concerns emanating from insurance legal entities that state insurance regulatory authorities are specifically designed to address."⁵ He further noted that "suggestions or assertions that [enhanced prudential standards] would more effectively address the identified potential risks should be supported by a description of the tools [and] how they explicitly address the systemic risks identified."⁶

Recommendations

To address these flaws, we have several recommendations. First, firm-specific designations should be used as a last resort and only in the rarest of circumstances, if at all. A more constructive approach would be for the FSOC to enhance its risk-monitoring tools, identify any potential specific systemic risks or concerns (whether within a firm or the sector), and work directly with the relevant regulators to address such concerns. We have long believed that the insurance sector should not be involved in systemically risky activities and have asked the FSOC to identify with specificity concerns regarding activities in the insurance sector or individual firms that give rise to such risks. We are committed to taking action to address such risks when identified, communicated to us, and where action is warranted. In fact, the concerns that have been brought to the attention of state insurance regulators to date are issues that state regulators

⁵ View of Adam Hamm, former North Dakota Insurance Commissioner, Designation of MetLife, Inc., September 17, 2014, at 3.

⁶ Id.

were already addressing through improvements to existing regulatory authorities including establishing a captive reinsurance framework and requiring more securities lending disclosures. In addition, the NAIC initiated a macro-prudential project, which will enhance our own macro-prudential toolkit and improve liquidity regulation. U.S. financial stability would be better served if the FSOC and regulators work together to resolve concerns through traditional regulatory authorities.

Second, firm-specific designations, if they are to be used at all, should be temporary measures. In this regard, notwithstanding our concerns with the designations to date, in cases where companies are designated, the FSOC should establish a clear “exit ramp” process for designated firms. While we acknowledge that the FSOC is statutorily required to review the firms on an annual basis, to date, this annual review process has failed to yield any specific information for regulators or companies as to the nature of risks that would need to be mitigated for a designation to be rescinded. As part of the designation process, the FSOC should specifically delineate the risks of concern so designated firms can put together a plan to address these concerns and submit it to the FSOC for feedback. It is also critically important that the primary regulator is closely consulted throughout the process.

Third, we urge policies that are more inclusive of state insurance regulators in the FSOC’s work. The U.S. insurance regulatory structure is a 56 state and jurisdiction system that relies extensively on the network of regulators within state insurance departments and the resources provided by the NAIC. Prohibiting the state insurance regulators’ FSOC representative and his staff from fully collaborating with their colleagues within the states and the NAIC to assist the FSOC’s work is antithetical to the operation of the state-based system of insurance regulation. While we understand structures are needed to ensure confidentiality, robust confidentiality structures already exist within the state-based system, and it is to the detriment of the FSOC, the insurance sector, and the U.S. to prohibit state insurance regulators from bringing the entire scope of their resources to bear for purposes of the FSOC’s important work.

Fourth, to address the structural issues within the Council’s composition, the role of the state insurance regulator should be elevated within the Council. The Treasury Department should recommend to Congress that the state insurance regulator representative be given a vote in a manner that complies with the appointments clause of the U.S. Constitution. States are the primary regulators of the insurance sector, yet are the only primary functional regulators without a vote. States have the necessary expertise and information regarding the sector to inform the FSOC’s risk monitoring work and help identify any systemic risks that impact the insurance sector. In addition, states are the only members of the Council that can commit to take regulatory action across the insurance sector in response to calls for a coordinated approach to address any risks that the Council may identify or other relevant regulatory concerns that may arise.⁷ Further, there should be processes established to give deference to the statutorily identified independent experts on insurance, particularly the sector’s regulators.⁸

⁷ The Federal Reserve has limited regulatory authority within the insurance sector as they only regulate FSOC designated firms and depository institution holding Companies with insurance operations. Neither the Independent Member with Insurance Expertise nor the Federal Insurance Office have any regulatory authorities over the insurance sector.

⁸ While the Director of the Federal Insurance Office is a non-voting member of the Council, he is an employee of the Treasury Department, ultimately reports to the Secretary of the Treasury, and therefore is not independent.


Conclusion

Thank you for your consideration of this submission. Should you have any questions, please don't hesitate to contact Ethan Sonnichsen, Managing Director of Government Relations, at esonnichsen@naic.org or 202-471-3980 or Mark Sagat, Assistant Director, Financial Policy and Legislation, at msagat@naic.org or 202-471-3987.

Sincerely,



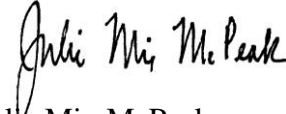
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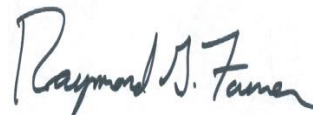
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