National Association of Insurance Commissioners & The Center for Insurance Policy and Research

March 25, 2015

The Honorable Richard Shelby
Chairman
Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Hearing entitled "FSOC Accountability: Nonbank Designations"

Dear Chairman Shelby and Ranking Member Brown:

On behalf of the National Association of Insurance Commissioners (NAIC)[1], thank you for the opportunity to submit this letter for the record regarding the Financial Stability Oversight Council (FSOC) and its nonbank designations process. Our comments are informed not only from the collective experiences of state insurance regulators, but also the work of those of us that currently or previously have represented state insurance regulators on the FSOC since its inception. Since the early days of the debate over the Dodd-Frank Act, the NAIC has long believed that monitoring and mitigating systemic threats to our financial system and economy would require collaboration among regulators through a council, such as FSOC. Indeed, we believed then as we do now that the prospect of the FSOC bringing together regulators from banking, insurance, and market regulation, each with different perspectives and expertise, could provide a robust mechanism for monitoring the financial system for risks. It has long been our view that a group of regulators with diverse experience can do more collectively than any single regulator could do individually, and preserves the healthy independence and checks and balances necessary to avoid an all-powerful regulatory czar.

While we continue to believe in FSOC's underlying objective, now coming up on its 5th year anniversary, it is clear that FSOC's operations and structure are far from perfect, particularly in the arena of nonbank designations. The NAIC appreciates the steps FSOC has taken to enhance transparency with its recent changes to its nonbank designation process and believe it is a good first step. However, it is apparent to us that more needs to be done. We applaud your commitment to Congressional oversight and exploring ways to improve FSOC.

First, after close to five years and three insurance company designations, we are deeply concerned that the FSOC's consideration of the insurance business model and the efficacy of state insurance regulation appears flawed at best, exacerbated by an apparent and consistent disregard of the views of FSOC

[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.

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members who know and regulate the sector best. This is most clearly evidenced by the designation of two insurance companies, Prudential and MetLife, over the objections of both the independent member with insurance expertise and the undersigned state insurance regulator representative, who all identified serious analytical and factual flaws in these designations. At bare minimum, there should be processes in place to give deference to the statutorily identified experts on insurance to ensure that non-insurance experts cannot overrule the insurance experts based on incorrect premises. 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 nonbank space and are unlikely to be focused on the protection of insurance consumers, the availability of insurance products, or competitive imbalance within insurance markets. It may be worth exploring an alternative structure for nonbank designations that provides equal weight of the votes of those that regulate the banking sector with those FSOC members that regulate other financial sectors.

Second, notwithstanding our disagreement with FSOC's decision to designate Prudential and MetLife, we are even more troubled by the lack of clarity provided to regulators or even 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 from the risks the company poses because regulators and the company have little information on how to address the company's risk to the system. Moreover, FSOC has historically relied on the first determination standard, which merely requires the FSOC to determine that a nonbank financial company's material financial distress "could pose a threat to the financial stability of the United States"[2] rather than the second determination standard, which would require an identification of activities of concern. The reliance on this standard coupled with the failure of FSOC to set forth plausible scenarios as to how the company's failure could have impacts on the financial system as well as a highly deferential "arbitrary and capricious" review by a federal court creates an "impossible burden of proof for companies to meet as it effectively requires [a firm under consideration] to prove that there are no circumstances under which the material financial distress of the company could pose a threat to the financial stability of the United States."[3]

In addition, FSOC has not taken steps to set forth an "exit ramp" for designated firms. While FSOC is statutorily required to review the firms on an annual basis, 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 or the nature of the actions that would have to be taken for a designation to be rescinded. We believe the failure of FSOC 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 nonbank designation process that contributes to rather than reduces risks to the financial system. Policymakers should not be lulled into a false sense of security that labelling a firm systemic, applying an additional "SIFI surcharge," and requiring it to file a resolution plan will meaningfully change a firm's risk profile in the absence of further action to reduce or eliminate the threats of concern. If FSOC is unable or unwilling to change its process to address such flaws, we believe it is incumbent on Congress to do so in order to protect financial consumers and the financial system of the United States.

Last, we have deep concerns about the lack of involvement of state insurance regulators in FSOC deliberations. While in recent years FSOC has made efforts to formally consult with state insurance regulators throughout the nonbank designations process as required by the Dodd-Frank Act and FSOC's

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[2] Dodd Frank Act §113

[3] View of Adam Hamm, the State Insurance Commissioner Representative, on the Designation of MetLife, Inc. at 6.

own Nonbank Designations Rule and Guidance, the typical one-off nature of such consultations remains troubling. In fact, FSOC has not yet even signed Memoranda of Understanding with all the state insurance departments. Unlike our federal counterparts, insurance is primarily regulated by 56 states and jurisdictions that work together through the NAIC. Though the Chair of a federal agency that sits on FSOC could apprise agency staff of issues discussed at FSOC that may impact the sector they regulate, prohibitions placed on FSOC members have prevented our representatives from discussing issues with us that could impact the insurance sector. It would also stand to reason that to the extent FSOC identifies systemic risk concerns that emanate from the insurance sector, FSOC would want to apprise regulators of such concerns so we could use our authorities to address them. The fact that FSOC has not yet set up robust processes to do so is a critical flaw in FSOC's operations and potentially puts the insurance sector at risk.

Thank you once again for the opportunity to provide these comments to the Committee for its consideration. We appreciate your continued robust oversight over the FSOC and look forward to working with you as the Committee considers potential changes to its structure and operations.

Sincerely,

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