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Averting Systemic Risk: Building an Exit Ramp for Designated Nonbanks

- *The NAIC has long believed that systemic risk should not exist in the insurance sector, and therefore any designation by the Financial Stability Oversight Council (FSOC) should be temporary and regulators should be given the insights necessary to actively work to de-risk such firms.*

- *Failure to provide regulators and companies sufficient clarity on the specific activities that led to a designation undermine FSOC's fundamental mission to mitigate risks to the financial system. In order to reduce systemic risk in our financial system, a designated company and its regulator should be provided clear guidance as to what steps need to be taken to be de-designated.*

- *The NAIC supports proposed reforms to the FSOC's opaque processes such as those put forth in the FSOC Improvement Act (HR 1550), the FSOC Designation Review Act (HR 4248), and the Financial Regulatory Improvement Act (S. 1484). We believe these proposed reforms represent positive steps forward in improving FSOC's operations, procedures, communication, and transparency.*

Background

The Dodd-Frank Act created the FSOC in order to bring together regulators from banking, insurance, and market regulation, each with different perspectives and expertise to provide a robust mechanism for monitoring the financial system for risks. Chaired by the Secretary of the Treasury, the ten voting member council has the authority to designate firms as "systemically important financial institutions," or SIFI's. Designated firms are subject to enhanced prudential standards including resolution planning, capital surcharges, and additional supervision by the Federal Reserve.

To date, FSOC has voted to designate three insurance companies – AIG, Prudential and MetLife, the last two over the objections of the voting independent member with insurance expertise and the state insurance regulator representative. MetLife's designation has since by rescinded by a federal court, though FSOC is appealing that ruling. In all these cases, FSOC failed to provide sufficient clarity to regulators or the companies as to the type and scope of the activities of concern that FSOC felt justified the designation and would need to be addressed in order to reduce the company's potential threat to the financial stability of the United States. While FSOC is statutorily required to review designated firms on an annual basis, this process has also failed to yield any specific information for regulators or companies as to the nature of risks that would need to be mitigated or actions that would have to be taken for a designation to be rescinded.

Key Points

- ✓ Notwithstanding state regulators' disagreement with FSOC's decisions to designate Prudential and MetLife, even more troubling is the lack of clarity provided to primary regulators or designated companies on the specific issues of concern that led to designation.

- ✓ The failure to set forth a clear rationale 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 risk to the financial system by lulling policymakers into a false sense of security that Fed supervision and enhanced prudential standards will reduce the risks designated firms pose to the system.

- ✓ If FSOC is unable or unwilling to change its process to develop and provide an "exit ramp" for designated firms, we urge Congress to do so in order to protect financial consumers and the financial system of the United States.

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