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

June 3, 2010

The Honorable Barney Frank
Chairman, Committee on
Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Christopher J. Dodd
Chairman, Committee on
Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Spencer Bachus
Ranking Minority Member, Committee on
Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Richard Shelby
Ranking Minority Member, Committee on
Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

**RE: Conference on Financial Regulatory Reform Legislation**

Dear Chairman Frank, Chairman Dodd, Ranking Member Bachus, and Ranking Member Shelby:

As the House and Senate move to produce a consensus on financial reform legislation, we write on behalf of state insurance regulators to offer our perspective on various components of the two proposals. We thank you for working with the National Association of Insurance Commissioners (NAIC) to include several necessary safeguards to ensure state insurance supervision is preserved, and not unintentionally undermined, within the framework of the legislation. We now ask you to preserve those safeguards in the legislation that is reported out of conference.

As you know, state regulation of insurance has worked extremely well for consumers during the current financial crisis, protecting policyholders from contagion risk and prohibiting insurance companies from engaging in the kinds of risks that crippled other parts of the financial sector. While insurance may not pose systemic risk, insurance companies may be affiliated with entities that do. Consequently, state law already provides broad authority to insurance commissioners to "wall off" insurance subsidiaries from the rest of a holding company. This authority is what protected AIG's insurance policyholders from the instability of the AIG holding company, and must not be altered or impeded by federal reform legislation. Indeed, it is this rationale – isolating stable and secure products from risk and speculation – that has motivated much of the financial reform debate.

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We want to ensure the legislation ultimately enacted addresses those issues, gaps or weaknesses exposed by actual events, and avoids unnecessary or counterproductive changes to healthy and functioning elements of the financial system.

Specifically, we ask that you work to preserve the House-passed language in the following three areas:

**Federal Insurance Office (FIO)/Office of National Insurance (ONI)**

State insurance regulators worked closely with Members of the House Financial Services Committee, as well as with consumer groups and the insurance industry, to carefully craft language to create a federal office on insurance with narrow authority to implement mutual recognition or equivalence agreements as part of the House-passed bill. The resulting Federal Insurance Office (FIO) approach ensures the federal government has information and expertise on the insurance sector, provides that international agreements are subject to appropriate review and input, and protects against unnecessary preemption of state law.

Under this legislation, the Department of the Treasury, for the first time, would have the power to make determinations on the preemption of state insurance measures, so it is essential that the preemption provisions be only as broad as necessary to achieve the narrow objectives of the office and that appropriate procedural safeguards be in place to protect against any broadening of that preemptive effect. The Office of National Insurance (ONI) provisions in the Senate-passed bill do not meet that test.

We therefore strongly urge your support in conference to strike the Senate ONI language and replace it with the House FIO language.

**Financial Stability Oversight Council (FSOC)**

A Financial Stability Oversight Council that impacts insurance companies demands the input, expertise and information resources of an active insurance regulator. Again, we believe the business of insurance, while an important sector of the financial system, is not likely to pose systemic risk since it is closely regulated for solvency, with investment restrictions and low leverage.

To ensure the credibility of FSOC decisions impacting the insurance sector, the Council should have an active insurance regulator participating equally in its discussions. This will serve as an early warning system in identifying practices and risk-related trends that contribute to systemic risk. We are pleased the House bill contains language to place a state insurance regulator on the FSOC in a non-voting capacity. The Senate approach adds an individual with insurance expertise in a voting capacity. The Senate approach ignores the fact the FSOC is a regulatory body, and it demands the commitment, expertise, and regulatory data that only an active state insurance commissioner can bring.

We therefore ask for your support to retain the House-passed language providing for non-voting membership for state banking, insurance and securities regulators on the Financial Stability Oversight Council.

## Consumer Protection

We are pleased that both the House and Senate proposals recognize state insurance regulators should continue to oversee insurance consumer protections without a duplicative federal regulator. However, the new consumer protection authority proposed by the House and Senate would consolidate federal authority to implement numerous laws, including the Gramm Leach Bliley Act (GLBA). The House legislation includes clarifying language that the federal consumer protection authority should not exercise any authority embedded in GLBA that has been granted to state insurance regulators, such as the development of privacy notices. This clarifying language should be included in final legislation.

We also appreciate the opportunity to comment on the following issues:

## Systemic Resolution/Dissolution Authority

Both the House and Senate proposals have recognized the existing state authority and infrastructure in place to wall off, rehabilitate, and if necessary, liquidate, a troubled insurance company. Again, it is this authority that allows state regulators to protect insurance policyholders from failing insurers and holding companies, much in the way the FDIC seeks to protect bank depositors. This authority must be maintained, and we urge you to retain provisions excluding insurance companies from systemic resolution authority. Despite unfounded concerns from some circles, our state guaranty fund system has robust capacity to resolve insurance company failures and provides an important incentive to the insurance industry to manage risk and promote solvency, as insurers are assessed for the failures of their fellow competitors. Given that policyholder dollars are paid into a proven system of resolution (coupled with appropriate solvency standards), these policyholder dollars should not also be used to pay for the failure of systemically risky entities within the new federal authority.

## Proprietary Trading/Derivatives

Insurance companies invest policyholder premiums consistent with state investment laws allowing them to seek a return on capital. This type of direct investment, which helps keep insurers solvent and helps keep pricing competitive, is disclosed to and overseen by state insurance regulators. Such regulated activity should not be unintentionally precluded by the proposed “Volcker Rule” in the Senate legislation. The NAIC worked closely with Senators Merkley, Levin, and Hagan to develop language that clarifies insurers can continue to invest consistent with existing state laws and guidelines. To the extent the proprietary trading provision is included in a final bill, this clarification should be included.

By definition, insurers assume risk to protect the assets and property of policyholders. Consequently, insurers often use derivatives to manage and hedge this existing risk. These transactions are disclosed to state regulators and must be consistent with conservative state investment rules. Appropriate transparency and collateral are essential to a stable derivatives marketplace, and insurers are currently operating in this environment. To the extent final legislation seeks to improve derivatives supervision, we believe insurers should continue to utilize derivatives for hedging purposes consistent with state rules and laws.

Again, we thank you for your efforts, and we look forward to continuing our partnership with Congress to ensure the nation's system of insurance regulation can operate efficiently and effectively, while continuing to serve its paramount function of protecting insurance consumers. If you need additional information, please contact Ethan Sonnichsen or Moira Campion McConaghy of the NAIC Washington Office at (202) 471-3990.

Sincerely,

Jane L. Cline, Commissioner
West Virginia Insurance Department
NAIC President

Susan E. Voss, Commissioner
Iowa Insurance Division
NAIC President-Elect

Kevin McCarty, Commissioner
Florida Office of Insurance Regulation
NAIC Vice President

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