

# Navigating the Changing Landscape of Financial Services Regulatory Reform: The Impact on the Life Insurance Industry

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Jim Gallagher, *John Hancock*

Karen Shaff, *Principal*

Ken Cohen, *MassMutual*

Mary Jane Wilson-Bilik, *Sutherland*

Attorneys Serving Clients Around the World



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## Before financial crisis, Industry focused on state regulation

- Increase regulatory efficiency
- Minimize duplicative regulation
- Speed to market and national producer licensing
- Consistent standards for solvency

## Post-crisis shift to federal level

- Expect new overlay of federal regulation
- Goal is to affect the process so that any overlay is not duplicative, and is thoughtful and manageable.

- **Common Goals, but Unique Company Perspectives**
- **Industry Focus for Financial Services Regulation**
  - Office of National Insurance (ONI) /aka Federal Insurance Office (FIO)
  - ONI International Implications
  - Tier 1 Financial Holding Company Systemic Risk Regulator
  - Resolution Authority
  - Consumer Financial Protection Agency
  - Investor Protection: Fiduciary Duty
  - Regulation of Bank Holding Companies
  - Derivatives and the Securitization Market
- **Strategic Goal Remains – Optional Federal Charter (OFC)**
  - ONI: a stepping stone?

## Office of National Insurance (ONI)

**Proposal:** A new office in Treasury that collects and provides information on insurance matters with the authority to coordinate federal efforts on international matters.

**Impact:** The ONI would be a connector between a potential federal systemic regulator, state insurance regulators and international regulatory organizations.

**Industry Focus:** Ensure formal authority is delegated to ONI comparable to other Treasury Offices and SEC, CFTC, etc.

- Require the systemic risk regulator to consult with ONI before making decisions about which insurance groups should be Tier 1 FHCs.
- Provide that ONI will advise Congress on issues relating to the regulation of the business of insurance and reinsurance.
- ONI representation on Financial Services Oversight Council (coordinating body).
- Require Treasury to designate permanent staff to provide ONI with professionals with extensive insurance industry expertise.

**Industry Focus:** Improve international cooperation and create a level playing field.

- Provide that ONI is the designated representative for the US on issues concerning the regulation of insurance or reinsurance, including oversight, capital, leverage and liquidity standards.
- Authorize ONI to facilitate information sharing and coordination among international insurance and reinsurance policymakers and regulators.

**Proposal:** The Administration has called for Tier 1 Financial Services Holding Company (FHC) classification of any financial firms whose “size, leverage, and interconnectedness” could pose a threat to the financial system at large. The systemic risk regulator would be the Federal Reserve Board (Fed).

**Impact:** The definition of Tier 1 FHC is broad enough in scope to include insurance groups that could be subject to new oversight, capital, leverage and liquidity standards, and to examination and enforcement by the Fed.

## Industry Focus:

- Excluding insurance companies is politically unrealistic.
- Some insurers advocate for systemic risk council (rather than Fed as systemic risk regulator) with limited authority over functional regulated companies and ONI representation.
- Special recognition for holding companies that are also operating companies (mutual and fraternal life insurers).
- Issues raised by applicability to foreign-owned financial firms need to be addressed to assure that there is international coordination and consultation.

**Proposal:** A new regulatory regime that would address failing “systemically significant” financial institutions that fall outside of the purview of the FDIC.

**Impact:** This resolution authority would have the authority to place companies into receivership and administer their effective, orderly reorganization.

**Industry Focus:** Preserve state-based guaranty funds and receivers for troubled insurers.

- Minimize costs to insurers of assessments by resolution authority.

**Proposal:** A new federal agency modeled after the Consumer Product Safety Commission. The CFPA would have sweeping authority to oversee and regulate consumer financial products.

**Impact:** The CFPA's broad authority to regulate the design and marketing of financial products would likely be onerous and costly to our business model without any offsetting benefits for consumers.

**Industry Focus:** Exclude insurance, securities, and retirement services activity from the purview of the CFPA.

- Minimize impact on affiliated depository institutions.

## Investor Protection: Fiduciary Duty

**Proposal:** Open-ended grant of authority to the SEC to promulgate conduct rules for broker-dealers providing investment advice, deeming them to act as fiduciaries (with the goal of harmonizing BD and RIA conduct rules). SEC could ban certain sales practices, conflicts of interest, and compensation rules.

**Impact:** Would prohibit financial planners from providing investment advice while selling proprietary variable products and perhaps securities products on a commission basis.

**Industry Focus:** Ensure regulators have authority – and direction – to establish “scalable” standards for different categories of registered reps – no “one size fits all.”

- Preserve flexibility in compensation structures, so planners can continue to be compensated on a commission basis.

# Regulation of Bank Holding Companies

**Proposal:** The OCC and OTS would be merged into a consolidated National Bank Supervisor.

**Impact:** Would bring insurance companies with thrift bank subsidiaries under the Bank Holding Company Act (BHCA), which would add an additional layer of consolidated supervision and regulation by the Fed of the entire financial group. To engage in financial activities, BHC must be well-capitalized and well-managed.

**Industry Focus:** Do not apply the BHCA restrictions to thrifts, at least when the bank is a de minimus portion of the financial group's operation (by assets or revenue)

- Allow current thrifts to maintain their thrift charter.

# Derivatives and the Securitization Market

**Proposal:** The Treasury Department has delivered legislation to Congress that would regulate over-the-counter derivatives and credit default swaps via additional oversight, regulation, and transparency by a variety of federal agencies (SEC, CFTC, FDIC, the Fed), without divesting authority from state agencies.

**Impact:** Derivatives transactions could be centralized in a singular “clearing house” and all derivatives traders would be required to keep records, report data to regulators, meet minimum margin requirements, and have greater capital on hand.

## Industry Focus:

- Preserve customized products.
- Minimize costs to end-users by providing that any regulation allows various types of collateral, netting across products, and exempting from enhanced capital requirements.
- Industry use of derivatives should continue to be regulated by functional insurance regulator.

# Optional Federal Charter

**Proposal:** HR 1880 (Bean-Royce bill) offers insurers and producers the option to charter at the federal level. Would establish a new Federal Insurance Regulator to oversee the organization, regulation and supervision of national insurers, agencies and producers, as well as insurance holding companies. Federal insurance commissioner would represent the insurance sector on the coordinating council of financial regulators, and consult with the systemic risk regulator.

**Impact:** National Insurers would no longer be licensed by 50+ states and territories, thereby increasing regulatory efficiency and minimizing duplicative regulation. The Federal Insurance Regulator could encourage consistency in prudential standards at the federal level, and have a seat at the coordinating council of federal financial regulators.

**Industry Focus:** Streamlined regulatory structure with uniform and consistent laws, regulations and consumer protections

- Competitive (relative to banks and mutual funds) fairness
- Possibility of application to life insurers only (and not P&C or health)
- Ensure clarity around role of states for companies that elect a federal charter (e.g., collection of premium taxes)

# Challenges

- Who will be “regulator in charge” when all is said and done?
  - New expertise (at regulators and in-house) will be required
  - New challenges in regulatory coordination
- Systemic Risk Regulator and/or “regulator in charge” will have the ability to gather significant amounts of new information from everyone in the Industry, to make ongoing demands, and to require “corrective actions.”
- Challenges go beyond legal and compliance to fundamental aspects of the business.
  - Will require more heavily centralized organization over multiple businesses than exists today.

# Unified Industry Goals

- Optional Federal Charter remains the goal
- ONI: a stepping stone?