STATEMENT

OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING, & URBAN AFFAIRS

ON

"THE ROLE OF THE FINANCIAL STABILITY BOARD
IN THE U.S. REGULATORY FRAMEWORK"

JULY 8, 2015

STATEMENT MADE BY
THE HONORABLE DIRK KEMPTHORNE
PRESIDENT AND CEO
AMERICAN COUNCIL OF LIFE INSURERS

Chairman Shelby, Ranking Member Brown, and members of the Committee, I am Dirk Kempthorne, President and CEO of the American Council of Life Insurers (ACLI). ACLI is the principal trade association for U.S. life insurance companies with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the insurance marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI member companies offer life insurance, annuities, reinsurance, long-term care and disability income insurance, and represent more than 90 percent of industry assets and premiums.

ACLI appreciates the opportunity to address the impact of the Financial Stability Board (FSB) on the U.S. regulatory framework. ACLI recognizes the important role of the FSB in enhancing international cooperation and coordination among financial supervisory organizations. The FSB was formed in 2009 by the G20 to promote financial stability through reform of the international financial regulatory structure. Its membership includes financial regulators from 25 major nations, including the European Union; international financial institutions, such as the IMF and World Bank; and standard-setting bodies, including the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO). The U.S. representatives to the FSB are the Department of the Treasury, the Federal Reserve, and the Securities and Exchange Commission.

My testimony focuses on two standard-setting actions by the FSB and its member organizations that intersect with the powers and authorities of the Financial Stability Oversight Council (FSOC) and the Federal Reserve Board. Those standard-setting actions are the designation of "globally systemically significant" insurers and the establishment of an international capital standard for insurers. More specifically, ACLI is concerned that –

- FSB's designations of G-SIIs have prejudged FSOC's designations and placed designated insurers at a competitive disadvantage in the marketplace;

- The FSB and FSOC have not applied consistent standards to the designation of nonbank financial companies; and

- There is a potential for conflict between insurer capital standards being developed by the Federal Reserve Board and those under development by the IAIS. These new standards may also unnecessarily deviate from the existing, proven insurance risk-based capital regime U.S. state insurance regulators use today.

To address these concerns, ACLI is recommending that –

- The designation process for insurers should be replaced with "activities-based" regulation that avoids the negative consequences of designating individual companies merely because of size.

- The Federal Reserve Board should finalize the capital standards mandated by Congress last year in a manner that is consistent with the Insurance Capital Standards Clarification Act before agreeing to capital standards developed by the IAIS; and

- This Committee should exercise vigorous oversight of the capital standard-setting process by the Federal Reserve Board and the IAIS to ensure that the intent of Congress and the competitiveness of the U.S. insurance industry is preserved.

Before I address those issues, however, I would like to commend Chairman Shelby and the Committee for The Financial Regulatory Improvement Act of 2015.

Financial Regulatory Improvement Act

The Financial Regulatory Improvement Act reflects many of the principles of transparency, accountability, and due process that are supported by ACLI and its member companies. In particular the bill:

(1) Proposes important, meaningful reforms that would strengthen Financial Stability Oversight Council procedures and ultimately facilitate a reduction in systemic risk;

(2) Increases opportunities for stakeholder input and Congressional oversight of the International Association of Insurance Supervisors regarding the development of international capital standards. ACLI commends Senators Dean Heller (R-Nev.) and Jon Tester (D-Mont.) for their strong leadership on this issue;

(3) Requires the Federal Reserve Board to plan for the different kinds of nonbank financial companies, including insurance companies that it supervises; and

(4) Includes language from the Policyholder Protection Act of 2015, which would afford insurance policyholders in the context of a savings and loan holding company structure the same protections as those currently provided under the Bank Holding Company Act.

ACLI urges the Committee to move this important legislation to the full Senate for consideration.

FSB's Designations of Globally Systemically Important Insurers (GSIIs) Seems to Have Prejudged FSOC's Designations and Placed Designated Companies at a Competitive Disadvantage

Both FSB and FSOC have designated three U.S. insurers as "systemically important." In July 2013, the FSB, in consultation with the IAIS, designated nine insurers as G-SIIs, including three U.S. insurers: AIG, Prudential and MetLife.[1] These designations were based upon a methodology developed by the IAIS.[2] The FSB envisioned that designated companies would be subject to certain policy measures, which would be developed by the FSB and IAIS and implemented by member countries. Those policy measures include recovery and resolution planning requirements, enhanced group supervision, and higher loss absorbency requirements for non-traditional activities.

FSOC also has designated AIG, Prudential and MetLife as systemically important, subjecting them to supervision and regulation by the Federal Reserve Board. FSOC's designation of AIG occurred on July 8, 2013, just days before the FSB initial designations.[3] Prudential was designated by FSOC in September 2013,[4] and MetLife was designated in December 2014.[5] The regulation of these companies by the Federal Reserve Board includes heightened capital standards, resolution planning requirements, liquidity requirements, and risk management standards.

[1] Global Systemically Important Insurers (G-SIIs) and the Policy Measures That Will Apply to Them, Financial Stability Board, July 18, 2013.

[2] Global Systemically Important Insurers: Initial Assessment Methodology, International Association of Insurance Supervisors, July 2013.

[3] Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc., Financial Stability Oversight Council, July 8, 2013.

[4] Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc., Financial Stability Oversight Council, September 19, 2013.

[5] Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc., Financial Stability Oversight Council, December 18, 2014

FSOC's independent member having insurance expertise, Roy Woodall, has raised serious concerns about the timing of these designations. In his dissents to both the Prudential and MetLife designations, Mr. Woodall noted that the FSB's designations were taken in consultation with members of FSOC, and that these discussions appear to have predisposed FSOC's independent designation process:

> Although not binding on the Council's decision, the declaration of Prudential as a G-SII by the FSB based on the assessment by the U.S. and global insurance regulators, supervisors, and others who are members of the IAIS has overtaken the Council's own determination process.[6]
>
> It is clear to me that the consent and agreement by some of the Council's members at the FSB to identify MetLife a G-SIFI, along with their commitment to use their best efforts to regulate said companies accordingly, sent a strong signal early-on of a predisposition as to the status of MetLife in the U.S -- ahead of the Council's own decision by all of its members.[7]

ACLI shares Mr. Woodall's concern. FSOC has a mandate to designate non-bank financial companies for supervision by the Federal Reserve Board based upon criteria established by Congress, and FSOC's designation decisions should not be pre-determined by the actions of the FSB.

A lack of transparency and due process compounds this concern. While the FSB has stated that it follows a designation methodology developed by the IAIS, the FSB designations are not accompanied by any explanation or rationale. Nor are designated companies accorded any ability to engage directly with the FSB or

---

[6] http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf.

[7] http://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf.

challenge a designation. Moreover, there is no transparency surrounding the FSB's actual directions to the IAIS, other than what the IAIS or FSB chooses to announce after the fact.

The immediate and potential negative consequences of designation are significant. The insurance industry is highly competitive, and the additional regulation imposed upon a designated company can place that company at a significant competitive disadvantage relative to its non-designated competitors. Capital standards are the most obvious example. If capital requirements on designated insurers are materially different from those imposed by the states, designated insurers may find it difficult to compete against non-designated competitors, resulting in a loss of business or an altered product mix. Less competition or less product availability is not in keeping with a healthy market that best serves insurance consumers. Even before any additional regulation is implemented, the prospect of such regulation has an immediate impact as it forces designated companies to manage their operations taking into account looming but unspecified regulatory requirements.

<u>FSB and FSOC Should Pursue "Activities-Based" Regulation of Insurers Rather than Designating Individual Companies</u>

FSB and FSOC have taken markedly different approaches in their treatment of different categories of nonbank financial companies. While FSB and FSOC have designated three U.S. insurers for heightened supervision and regulation, they are pursuing an "activities-based" approach for asset managers rather than the imposition of heightened regulation on individual companies merely because of size.

Recent public statements by Federal Reserve Board Governor Daniel Tarullo and by Greg Medcraft, the Chairman of IOSCO, have acknowledged this different treatment accorded asset managers over insurers.[8]

The difference in treatment also is evident in the manner in which FSOC has approached the evaluation of insurers and asset managers. Instead of designating asset managers, FSOC has directed its staff to "undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry."[9] This request followed the release of a study by the Office of Financial Research on asset management and financial stability, which FSOC had requested "to better inform its analysis of whether – and how – to consider such firms for enhanced prudential standards and supervision."[10] This request also followed a conference on the asset management industry by FSOC "to hear directly from the [asset management] industry and other stakeholders, including academics and public interest groups, on [the asset management industry and its activities]."[11] At that conference, FSOC members heard from representatives of the Securities and

---

[8] See, Conversation with Governor Tarullo, Institute for International Finance, North American Summit, June 4, 2015; https://www.youtube.com/watch?v=dV1tJMX-z2c&feature=player_embedded; and Remarks of Greg Medcraft, Chairman, International Organization of Securities Commissions, to the National Press Club, Washington, DC, on "IOCSO and the International Reform Agenda for Financial Markets," June 22, 2015.

[9] Press Release, U.S. Treasury Department, Financial Stability Oversight Council Meeting, July 31, 2014.

[10] Office of Financial Research, Asset Management and Financial Stability, Sept. 2013. [11] Press Release, U.S. Treasury Department, Financial Stability Oversight Council (FSOC) to Host Public Asset Management Conference, March 28, 2014.

[11] Press Release, U.S. Treasury Department, Financial Stability Oversight Council (FSOC) to Host Public Asset Management Conference, March 28, 2014.

Exchange Commission, the Bank of England, New York University, Columbia Business School, and the Wharton School, as well as several asset management companies. No such public hearing was conducted to engage insurers and other stakeholders about the insurance industry.

In sum, the FSOC's actions with regard to the asset management industry stand in sharp contrast to FSOC's treatment of the insurers. FSOC has pursued the designation of individual insurance companies and provided the public with little, if any, insight into the rationale for those designations or how designations could have been avoided.

Moreover, FSOC has pursued this approach despite the fact that one of the principal authors of the Dodd-Frank Act has stated publicly that he sees no difference between the asset management industry and the insurance industry when it comes to systemic risk. In a hearing before the House Financial Services Committee last year, former Congressman Barney Frank told the Committee that "I don't think asset managers or insurance companies that just sell insurance as it's traditionally defined are systemically defined… Their failure isn't going to have that systemic reverbatory [sic] effect."[12]

ACLI finds this disparate treatment of insurers inexplicable and distressing. Why has FSOC undertaken a thoughtful analysis of one category of nonbank companies, but not another? Why has FSOC concluded that an "activities-based" approach to regulation is appropriate to asset managers, but not insurers?

---

[12] Assessing the Impact of the Dodd-Frank Act Four Years Later Before the H. Comm. On Fin. Serv., 113th Cong., Statement of the Honorable Barney Frank during question and answer session, unofficial transcript.

The Dodd-Frank Act gives FSOC two principal powers to address systemic risk. One power is the authority to designate nonbank financial companies for supervision by the Federal Reserve Board. The other power is an "activities-based" authority to recommend more stringent regulation of specific financial activities and practices that could pose systemic risks.

FSOC's power to recommend more stringent regulation of specific activities and practices has distinct public policy advantages over its power to designate individual companies for supervision by the Federal Reserve Board. FSOC's power to recommend primary regulator action brings real focus to the specific activities that may involve potential systemic risk and avoids the competitive harm that an individual company may face following designation. As I have noted above, in certain markets designated companies can be placed at a competitive disadvantage to non-designated companies because of different regulatory requirements. Finally, the power to recommend avoids the "too-big-to-fail" stigma that some have associated with the designation of individual companies.

FSOC's recommendations for more stringent regulation of certain activities and practices must be made to "primary financial regulatory agencies." These agencies are defined in the Dodd-Frank Act to include the SEC for securities firms, the CFTC for commodity firms, and state insurance commissioners for insurance companies. A recommendation made by FSOC is not binding on such agencies, but the Dodd-Frank Act includes a "name and shame" provision that encourages the adoption of a recommendation. That provision requires an agency to notify FSOC within 90 days if it does not intend to follow the recommendation, and FSOC is required to report to Congress on the status of each recommendation.

ACLI believes that FSOC and FSB should both pursue an "activities-based" approach to insurers through their processes and not rely on designations, in the same manner that they are pursuing such an approach to asset managers. Failure to do so raises a fundamental question of fairness and casts doubt on the legitimacy of the policies and practices of FSOC and the FSB.

The Federal Reserve Board Should Finalize the Capital Standards Mandated by the Insurance Capital Standards Clarification Act Before Agreeing to IAIS Standards

Both the Federal Reserve Board and the IAIS are developing insurance capital standards that are likely to have significant impacts on life insurance companies. Considered together, these two initiatives directly affect approximately 60% of the direct premiums of ACLI member companies. If these standards are bank-centric or inconsistent with capital standards developed by state insurance supervisors, they will disrupt the marketplace and undermine the ability of life insurers to provide long-term, guaranteed retirement products to savers and retirees.

To ensure the best possible outcome for policyholders, the Federal Reserve Board should adhere to the intent of Congress as reflected in the Insurance Capital Standards Clarification Act, which was unanimously approved by Congress last year, and develop an insurance capital standard that is appropriate for U.S. insurers and the insurance business model. We are encouraged by the fact that the Board has indicated its intent to undertake a methodical, thoughtful approach to the development of these standards. Moreover, the Federal Reserve Board should partner with the other U.S. representatives to the IAIS (FIO and state insurance supervisors) to ensure that any international insurance standards reflect the unique strengths of the U.S. system of insurance supervision.

It is essential that policymakers correctly address insurance capital standards here in the U.S. first, so that our representatives to the IAIS, "Team U.S.A.," have a stronger, unified position in any international discussions. Common sense suggests that the U.S. should conduct its own process for the development of an insurance capital standard before agreeing to any international standards. The ACLI believes that it is in the best interests of the U.S. to focus on domestic rulemaking first and ensure that the domestic process is as thoughtful, informed, and transparent as possible.

The Federal Reserve Board's capital setting process should include formal rulemaking with notice and public comment, and ACLI is grateful that the Federal Reserve Board has indicated it will proceed in this way. Any insurance capital standard must reflect the long-term nature of life insurers' investments and the need to match investments with the long-term duration of insurance liabilities. Bank standards that favor short-term assets simply do not work for the insurance company business model, in which commitments to provide benefits to insurance policyholders and annuity contract holders often last many decades.

The ACLI has been actively engaged with the Federal Reserve Board on a proposed capital regime for insurance companies. The IAIS timeline must accommodate the Federal Reserve Board's implementation of the Insurance Capital Standards Clarification Act. These processes should not be abbreviated or confused by a rushed IAIS timeline. Just last month, the IAIS released a proposal for higher loss absorbency capital standards and reiterated plans to finalize these standards by the end of this year. The Federal Reserve Board's rulemaking process should proceed normally and allow ample time for notice and public comment. The three U.S. representatives to the IAIS should not agree to anything at the IAIS that would interfere with a robust and thoughtful rulemaking process here in the U.S. In fact, the IAIS process would benefit from the work being conducted by the Federal Reserve Board and should adjust its timeline accordingly.

ACLI is encouraged by the recent IAIS announcement to develop international insurance capital standards, particularly the ICS, through a staged and incremental process that will be more respectful of and informed by jurisdictional developments.[13] This is a clear example of Team U.S.A. working on all cylinders to achieve a positive outcome for U.S. insurers and insurance markets. However, much work remains to be done, including further and deeper consideration and analysis of what types of activities actually create systemic risk in the insurance model. Getting our standards completed at home needs to happen first.

[13] "The IAIS Risk based Global Insurance Capital Standard(ICS): Ultimate and Interim Goals, Principles for Development and Delivery Process" June 25, 2015

ACLI commends the three U.S. representatives to the IAIS for the important partnership that they have established in the Team U.S.A. approach. Only by working together, meeting regularly, coordinating their efforts, and agreeing to common objectives, the Federal Reserve Board, FIO, and state insurance supervisors are best positioned to represent the U.S. and secure the best outcome for U.S. consumers and insurers. The Team U.S.A. concept constitutes an effort to speak with a strong, unified voice as part of any IAIS discussions and ACLI fully agrees with the wisdom of this approach.

ACLI urges this Committee to exercise vigorous oversight of the capital standard-setting process by the Federal Reserve Board and the IAIS to ensure that the intent of Congress and the competitiveness of the U.S. insurance industry are preserved. Congressional oversight of the development of a workable domestic capital standard for U.S. insurers will help support the goal of a well-capitalized and competitive insurance industry that continues to serve the needs of U.S. consumers.