Financial Security...for Life.

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President & Chief Executive Officer

March 31, 2017

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Dear Secretary Mnuchin:

The American Council of Life Insurers (ACLI) appreciates the opportunity to share with you our comments on the President's Executive Order on the Administration's Core Principles for Regulating the U.S. Financial System.[1] We welcome the President's action and support the Executive Order's directive for you, in consultation with the other members of the Financial Stability Oversight Council ("FSOC"), to review existing federal laws and rules regulating the financial services sector to ensure they comport with the Core Principles. As you undertake this review, we respectfully request that you take into consideration the issues and comments outlined in this letter.

As you know, the Dodd-Frank Act was the federal government's primary regulatory reform response to the 2008 financial crisis. While some financial regulatory reform was warranted given the breadth of the crisis, we now have sufficient experience under these rules that it is appropriate to review what works and what does not under the Act. From the ACLI's perspective, the following issues should be considered during your 120-day deliberations and final report to the President:

- <u>FSOC's authority to designate insurers as systemically significant should be eliminated</u>.

  After review of FSOC's exercise of its authority to designate nonbank financial companies as systemically significant, we believe that Treasury's report to the President should recommend that that authority be repealed. We believe this recommendation is consistent with the Executive Order's Core Principles, as well as a proper understanding of the insurance sector, for the following reasons:

  - FSOC's inconsistent use of this authority as applied to different sectors of the financial services industry failed to properly identify the most "...efficient, effective and appropriately tailored..." policy response to address a financial stability threat, as is required by the Core Principles.
  - FSOC's failure to perform an impact analysis to demonstrate how nonbank designations would address systemic risk, which is inconsistent with the Core Principle directive of ensuring "more rigorous regulatory impact analysis that addresses systemic risk."

[1] The ACLI is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States

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- A complete disregard by many FSOC principals of the opinions and recommendations of those FSOC members that actually are experienced in the supervision, regulation, and oversight of insurance companies.
- An apparent complete disregard of the existing, long-standing and successful regime of insurance industry regulation overseen and enforced by its primary prudential regulators.
- A lack of transparency, accessibility and consistency in application of the authority to similarly situated institutions.
- A bank-centric regulatory reliance on an inappropriate and unrealistic bank-like "run" scenario on insurance products as the trigger of an insurer's financial distress or cause of systemic risk, reflective of the group's lack of understanding of both the insurance business and its existing strong regulatory regime.
- FSOC's narrow time and resource heavy focus on individual entities in certain sectors has diminished its more important role as a broad macro-prudential monitor of the potential threats to financial stability and the economy that can identify potential systemic risk in a timely fashion.
- FSOC's retained authority to advise on macro-prudential issues, including activities across industries that may pose systemic risk, fulfills the Act's purpose in stemming systemic risk to U.S. financial markets, without the manifest downsides of individual designations.
- Rather than addressing issues the FSOC might view as systemic more broadly in and among sectors of the financial industry, the SIFI designation process creates duplicative, inappropriate and/or inconsistent regulatory regimes and imposes significant costs and supervisory burdens and directives on designated companies, thereby distorting the marketplace.

The Core Principles' clear direction to prevent government bailouts while fostering economic growth will be served by this important change. The change is also consistent with the rationalization of the federal financial services regulatory framework. We agree that the cost of regulation and potential adverse economic effects must be the subjects of intense focus.

- <u>The primacy of FSOC's role in identifying macro-prudential risks should be reemphasized</u>.

FSOC's primary responsibility should be assessing macro-prudential risks to U.S. financial stability. It should be made clear that its principal roles are making advisory recommendations to primary financial regulators on applying new or heightened safeguards for financial activities that could increase risks to the U.S. financial markets and identifying risks in unregulated sectors or activities.

- <u>FSOC's insurance regulatory expertise should be significantly increased</u>.

FSOC's structure should be changed, including adding state insurance regulators as voting members. FSOC's actions to date reflect its dominance by bank regulators, discounting the opinions of the single insurance expert voting member, resulting in erroneous and harmful decisions affecting insurance companies. This structural change must also ensure that any FSOC recommendations that would affect insurers must be developed with direct input of state insurance regulators, and that any implementation of such recommendations is solely within the province and authority of those regulators. This change is directly supported by the Core Principles, particularly numbers 6 and 7 addressing efficient regulation and public accountability.

- The unique nature of insurer savings and loan holding companies must be recognized and the Federal Reserve Board must coordinate with state insurance regulators to the fullest extent possible in order to avoid duplicative, inefficient oversight activities.

All regulatory requirements applicable to savings and loan holding companies that have insurance entities must be based on the unique business model of insurers and the state-based financial regulatory system to which those companies are currently subject. In addition, the Federal Reserve Board is required by statute to actively and effectively coordinate with state insurance regulators in an effort to eliminate duplicative examination activities covering the insurance operations of these companies to the fullest extent possible. These considerations are entirely consistent with the Core Principles' emphasis on efficient, effective and appropriately tailored regulation and the Treasury's report to the President must seek to ensure that they are occurring in practice.

- The functions of the Federal Insurance Office should be retained and refocused.

The Federal Insurance Office's functions should emphasize federal efforts on prudential aspects of international insurance matters, including continued participation at the International Association of Insurance Supervisors. This is directly aligned with Core Principles 4 and 5 regarding American competitiveness and effective international regulatory negotiations. Some adjustment to its domestic portfolio may be appropriate, but it should remain an advisory arm to the federal government on insurance-related issues. Consideration should be given as to whether these functions should continue to be carried out by the Federal Insurance Office or elsewhere within Treasury, or under another existing agency. There should be clear direction for greater coordination between federal agencies and state insurance regulators.

- Resolution of insolvent insurers must remain under the authority of state insurance regulators.

As is currently the case, all insurance entities in financial distress should continue to be dealt with solely through the long-established and successful state-based rehabilitation and liquidation system.

- Continue and Re-emphasize the Consumer Financial Protection Bureau's lack of authority over the insurance business.

The Consumer Financial Protection Bureau's (CFPB) lack of authority over insurance companies and the business of insurance, amply justified by the robust consumer protections under state insurance laws, should be re-emphasized and, if appropriate, strengthened to ensure there is no CFPB encroachment on insurance activities and insurance regulation.

- Provisions addressing regulation of reinsurers and reinsurance should be retained.

The current provisions of Dodd-Frank Act Title V, subsection B, Part II dealing with regulation of reinsurance and reinsurers should be retained.

- Life insurers should be excluded from the mandatory clearing mandate.

Title VII of the Dodd-Frank Act requires all financial end-users of derivatives to make use of clearing mechanisms. Life insurers are unique financial end-users of derivatives because derivatives are predominantly used to hedge risk, as required by state insurance laws. The significant expense and burdens of mandatory clearing far outweigh any benefits, particularly in light of new margin requirements on uncleared swaps, increased clearing member concentration and continued concerns around clearinghouse safety and soundness. The need to post cash collateral to the clearinghouses forces life insurers to liquidate higher yielding securities for cash, resulting in higher hedging costs for products that may ultimately be borne by consumers. In addition, the directional nature of life insurer portfolios do not afford them the netting benefits experienced by dealers and other financial end-users. Properly tailored, effective regulation of derivatives should not include mandatory clearing for life insurers.

- <u>Life insurers should not be subject to punitive initial margin requirements on uncleared swaps.</u>

Rules implementing Title VII of the Dodd-Frank Act will require life insurers to post initial margin on uncleared swaps beginning in 2020. Given that are there are existing variation margin requirements for uncleared swaps, these rules should be amended to ensure that calculation methods used for initial margin are appropriately calibrated to the risk associated with the trading activity and credit quality of life insurers. Initial margin rules should not result in the imposition of overly punitive initial margin requirements on life insurers. Life insurers' estimates of future required initial margin amounts, compared to current clearinghouse requirements, indicate that these amounts will be outsized to the nature and risk of trades implicated.

Thank you for consideration of these comments. We believe the steps outlined in this letter will ensure alignment of federal oversight with the Core Principles. We welcome the opportunity to meet with you and your staff in the near future to discuss these items in greater detail.

Empowering Americans to save for retirement and promoting efficient and effective regulation are goals our industry shares with the Administration. Please feel free to contact me directly if you have questions or would like any additional information.

Very Truly Yours,

Dirk Kempthorne

CC: Craig Phillips, Senior Counselor to the Secretary
Steven Seitz, Acting Director, Federal Insurance Office