Statement for the Record

Submitted to the

U.S. Senate Committee on Banking, Housing, and Urban Affairs

March 14, 2019 Hearing Titled, "Financial Stability Oversight Council Nonbank Designations."

March 20, 2019

On Behalf of

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Chairman Mike Crapo (R-ID) and Ranking Member Sherrod Brown (D-OH), the American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the views of member life insurance companies regarding the Financial Stability Oversight Council's (FSOC) authority to require supervision and regulation of nonbank financial institutions as systemically important financial institutions (non-bank SIFIs).

On March 13, the FSOC issued for public comment proposed interpretive guidance regarding nonbank SIFI designation and determination processes. While our membership is still in the process of conducting a thorough review of the proposal, ACLI is highly encouraged with the Council's stated objective to ensure its work is clear, transparent and analytically rigorous, and enhances engagement with companies, regulators and other stakeholders. Importantly, the ACLI is supportive of the proposal for the Council to prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach (ABA), as well as reforms to enhance the analytical rigor and transparency in the processes the Council would undertake if it were to consider designating a nonbank entity as a SIFI subject to supervision by the Federal Reserve. We also appreciate the emphasis throughout the proposal to work more closely with the primary regulators, including the state regulators for insurance, for both the preferred activities-based approach as well as any possible designations.

The proposed guidance aligns with the U.S. Treasury's November 2017 report to the President of the United States on FSOC Designations. Treasury's FSOC report contains a number of important recommendations advocated by ACLI including prioritizing a sector-wide ABA approach to potential risks posed by nonbank financial companies; greater coordination and reliance on primary functional regulators; increasing the analytic rigor of determination analyses; improving engagement and transparency in the determinations process; and providing a clear "off-ramp" for designated nonbank financial companies. The report reflects many of the principles of transparency, accountability, and due process that are supported by ACLI and its members.

We applaud Senators Mike Rounds (R-SD), Doug Jones (D-AL), Thom Tillis (R-NC) and Kyrsten Sinema (D-AZ) for introducing bipartisan legislation, the "Financial Stability Oversight Council Improvement Act of 2019". This legislation would stipulate that the Council may not vote on a proposed determination with respect to a U.S. nonbank financial company unless the Council first determines, in consultation with the company and the primary financial regulatory agency with respect to the company, that a different action by the Council or the agency (including the application of new or heightened standards and safeguards under section 120 of the Dodd-Frank Act), or by the company under a written plan that is submitted promptly to the Council, is impracticable or insufficient to mitigate the threat that the company could pose to the financial stability of the United States. We commend Sens. Rounds, Jones, Tillis and Sinema for their leadership on this issue and look forward to a constructive dialogue concerning their bipartisan proposal.

## THE AMERICAN COUNCIL OF LIFE INSURERS

The ACLI advocates on behalf of 280-member companies dedicated to providing products and services that promote consumers' financial and retirement security. Ninety million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers' products for peace of mind. ACLI members represent ninety-five percent of industry assets in the United States.

## THE FSOC SHOULD PRIORITIZE AN ACTIVITIES-BASED OR INDUSTRY-WIDE APPROACH TO POTENTIAL RISKS POSED BY NONBANK FINANCIAL COMPANIES

While we believe the FSOC has a vital role to play in helping identify and mitigate potential systemic risk in the U.S. economy, the use of its authority with respect to past designations of nonbank entities as systemically important financial institutions (SIFI) was arbitrary, inconsistent and highly problematic. The use of its authority to designate individual firms as nonbank SIFIs ignored more efficient and effective regulatory tools to mitigate perceived systemic risk concerns, and diverted important resources away from its more important role as a cross-sectoral macro-prudential overseer of the economy that can identify potential systemic risk in a timely fashion.

The designation of insurers merely produced duplicative supervision and regulation requirements, excessive and unnecessary regulatory costs and burdens, and harmed competition in the insurance market place without actually identifying or mitigating perceived systemic risk. We are pleased and support the FSOC's recent decision to remove its insurance company designations and its intent to adopt an ABA to systemic risk moving forward.

In our view, prioritizing an ABA appropriately focuses FSOC's resources on identifying, assessing and mitigating potential systemic risk to U.S. financial stability. An ABA is much more efficient and effective than subjecting a handful of insurers, who are already highly supervised and regulated by state insurance regulators, with another layer of duplicative and potentially conflicting supervision and regulation particularly if based solely on size or perceived complexity. The use of an ABA would appropriately align the FSOC's principal role with making advisory recommendations to primary financial regulatory agencies, which for insurance companies are the state commissioners, on applying new or heightened safeguards for financial activities that could increase risks to the U.S. financial markets.

ACLI is highly encouraged by the proposed interpretive guidance, and particularly with the decision to transition away from entity-based determinations toward an ABA to protecting the U.S. financial system. ACLI particularly applauds the emphasis placed in the proposed interpretive guidance to leverage the knowledge and expertise of existing primary financial regulatory agencies to mitigate identified potential risks to U.S financial stability.

### *RECENT AND ON-GOING ENHANCEMENTS TO THE STATE-BASED INSURANCE SYSTEM*

Insurance companies have experienced prudential regulators that have greatly increased the tools available to oversee and effectively regulate the industry. In the last decade, state insurance holding company laws and group supervision practices have been strengthened and expanded to enable state regulators to be more vigilant in identifying, and aggressive in addressing, issues of concern that might jeopardize the insurance company as a whole. For example, insurance companies or groups are now required to submit their own risk and solvency assessments to state insurance regulators, who routinely review them with the group's management in cooperation with other regulators. Prudential oversight of insurance companies through the state-based system continues to be demonstrably strong and effective as it evolves to meet ongoing challenges.

Recently the NAIC has undertaken a new macroprudential initiative (MPI), which is designed to provide financial stability by analyzing existing macroeconomic trends, post-financial crisis regulatory reforms, and identifying potential enhancements and/or additions to further improve state regulators' ability to address macroprudential impacts. The goal of the MPI is to consider "new or improved tools" to enable regulators to better monitor and respond to the impact of external financial and economic risks on insurers that might be transmitted externally, and increase awareness of state legislators' monitoring capabilities regarding macroprudential trends. The NAIC has several MPI workstreams underway, including improved liquidity and counterparty risk exposure monitoring tools.

## FSOC SHOULD ENHANCE THE ANALYTICAL RIGOR AND TRANSPARENCY AND ENGAGEMENT WITH PRIMARY FINANCIAL REGULATORS WHEN CONSIDERING MAKING A DETERMINATION TO SUBJECT A NONBANK FINANCIAL COMPANY TO SUPERVISION BY THE FEDERAL RESERVE

We are pleased that recent activities of the FSOC have demonstrated a clear objective to address prior shortcomings of the designation process by leveraging the expertise of primary financial regulators, appropriately tailoring regulations to cost-effectively minimize burdens, and ensuring the Council's designation analyses are rigorous and transparent.

We believe it's imperative for the FSOC to revise its interpretive guidance to codify certain existing practices as well as to implement new enhancements to its processes. Enhancing the analytical rigor and transparency, along with engagement with primary financial regulators, will greatly benefit regulators, industry and the public should the FSOC consider using its designation authority at some point in the future.

### *INCONSISTENT PROCESS AS APPLIED TO DIFFERENT SECTORS OF THE FINANCIAL SERVICES INDUSTRY; LACK OF UNIFORM, CONSISTENT OR TRANSPARENT METHODOLOGY*

The FSOC process has been extremely inconsistent as applied to different sectors of the financial services industry. This broad discrepancy in application of FSOC's authority is illustrated by the very different approaches taken towards different industries, without explanation. The insurance industry has seen individual companies subject to scrutiny and designation, while for other industries FSOC has focused on reviewing and identifying specific practices that may pose significant risk, or taken no action at all rather than singling out and designating specific firms.

Within the insurance sector itself, for past FSOC designation processes, there was no evidence of a uniform, consistent or transparent methodology being applied to each individual company under review. Life insurance companies that had gone through the designation process did not receive adequate information or explanation of FSOC analyses and decisions. Documents provided by FSOC to insurance companies offered little insight into the basis for designation decisions. These documents typically offered only conclusory statements, predictions, and speculations that are unsupported by factual and economic analysis or historical precedent. At the time, companies were not provided with enough information that would allow them to take positive steps to avoid designation or be de-designated through appropriate action.

### *THE ROLE OF PRIMARY FINANCIAL REGULATORS*

Of particular concern with the FSOC process as applied to insurers had been its past failure to appropriately consider the role of existing primary financial regulators. This led to a lack of understanding and failure to recognize the strong insurance regulatory framework in place through the state-based system, even though one of the explicit statutory requirements FSOC is directed to consider is the "degree to which the company is already regulated by one or more primary financial regulatory agencies". The state-based insurance regime has a long and successful track record of insurance regulation. In the past, and contrary to this statutory requirement, the FSOC has not appropriately considered the authority and tools available under the state-based insurance regime, including numerous and substantial reforms policymakers have implemented since the financial crisis. Failure to appropriately consider the role of existing primary financial regulators was another sign of the lack of due process in FSOC designation of individual insurers. This fundamental shortcoming was repeatedly highlighted by the voting member of FSOC with insurance expertise.

*APPLICATION OF THE MATERIAL FINANCIAL DISTRESS STANDARD HAS FAILED BASIC PRECEPTS OF ACCOUTABILITY, TRANSPARENCY AND CONSISTENCY*

The Dodd-Frank Act authorizes FSOC to designate a nonbank financial company for supervision by the Federal Reserve Board if either (1) material financial distress at the company, or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the company, could threaten the financial stability of the United States. Each of the initial designations made by FSOC had been based on the material financial distress standard alone. In each case, FSOC simply assumed the existence of material financial distress had or could occur at the company, and then concluded that such distress could be transmitted to the broader financial system.

We believe that past FSOC analysis used a flawed application of the material financial distress standard for designation. This led to distorting the purpose of designations by failing to account for the vulnerability of prospective designees, and departs from the requirements of the Dodd-Frank Act and FSOC's own regulatory guidance.

In closing we support issuing clear and transparent guidance to provide nonbank companies with sufficient information to understand the Council's concerns regarding risks to financial stability, ensure its work is analytically rigorous, and to promote leveraging the knowledge and expertise of primary financial regulators.

## CONCLUSION

The ACLI thanks the Committee for convening this important hearing and for its comprehensive oversight over the non-bank financial institution designation process. We support FSOC's decision to revise its interpretive guidance and support legislation that would codify the requirement to use ABA prior to considering an entity-based approach for mitigating perceived systemic risk concerns. We look forward to working with policymakers to ensure FSOC's future focus remains on the overall financial stability of the U.S. economy.