From: Martin Carus Consulting, Martin F. Carus

Proposal: 1540 (7100-AE54) Reg YY - Enhanced Prudential Standards Systemically Important Insurance Companies

Subject: Reg YY - Enhanced Prudential Standards for Systemically Important Insurance Companies

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Comments:

. My name is Martin F. Carus, President of Martin Carus Consulting LLC.

. I spent 34+ years with the State of New York Insurance Department rising through the Civil Service System to Chief Examiner with a focus on financial regulation of insurance companies. I was active in various groups at the NAIC dealing with a wide range of financial evaluation, accounting and reporting matters including e.g., the devising of the NAIC's Model Investment Laws, the reporting blank (Schedules F, dealing with reinsurance, and P dealing, with property/casualty loss reporting) and was integral to the development of the codification of statutory accounting).

. I then spent 15 years with AIG as Senior State Relations Officer, several of which involved representing AIG in its Observer status at the IAIS focusing on financial regulatory matters.

. Since 2014, I have consulted on projects relating to insurance regulatory matters and published several articles relative to insurance capital requirements and the development of group capital requirements, particularly as regards the efforts of the IAIS and the NAIC.

. In my years in the insurance industry I have worked with your Mr. Sullivan when he was Commissioner of Insurance in Connecticut and Ms. Duzick when she was with the Office of Thrift Supervision inasmuch as she was the Examiner-in-Charge of AIG prior to September 2008.

. I am a taxpayer.

. I am a voter.

. I am a policyholder under policies related to life insurance, health insurance, homeowners insurance, automobile insurance, liability insurance, and disability insurance.

. I am a shareholder of a company principally engaged in insurance activities.

. I am also outraged!

. In your summary you cite Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act stating specifically, that you are "inviting public comment on the proposed application of enhanced prudential standards to certain nonbank financial companies that the Financial Stability Oversight Council has determined should be supervised by the Board." (italics mine)

. Merriam-Webster's "Learners Dictionary" notes that "enhanced" is a past tense transitive verb with an obsolete meaning of "raise." The meaning is therein defined as: "to increase in value, quality, desirability, or attractiveness." You have put forth the instant proposal (some 97 pages) along with an interrelated proposal (dated June 3, 2016 related to 12 CFR Chapter II) regarding capital requirements for supervised institutions significantly engaged in insurance activities (some 36 pages) without clearly indicating a quantification, in dollars and cents, of just how these proposals increase value, quality, desirability, or attractiveness to me, or anyone else for that matter! In other words, there is no cost-benefit study included in your proposal. How can that be? If any institution you supervised were to propose a major action without such a cost-benefit analysis, would you conclude that its risk management or overall management processes were functioning reasonably?

. The cost incurred to date and the future costs of formulating and finalizing your proposal, as well as the costs of implementation, compliance and follow-up evaluation are borne by one or more of the following constituencies: taxpayers, shareholders or policyholders. Such costs have not been inconsequential and generally, the costs will inure to the latter constituency which is of little solace to me inasmuch as I fall into that group and in any case, I am a member of all three (curiously so are you, as is almost every reader of this tirade). I note that similar efforts are being undertaken by the IAIS and the NAIC which exponentially raises the total costs involved in these efforts. Just what am I (and you), as a either a taxpayer, shareholder or a policyholder, getting for defraying these costs? You don't say. In the past, all I have been able to glean is that there is a nebulous notion that "more" regulation, regardless of cost, is somehow better or that the outcome of these efforts will ensure that taxpayers will not have to bailout future insolvent institutions. Usually, there is the usual accompanying reference to the AIG situation that goes along with that generalization. However, with the obvious exceptions of the Louisiana Purchase and the purchase of Alaska (and perhaps further the Gadsden Purchase), it seems that the "bailout" of AIG has proven to be one of the shrewdest and most profitable investments the taxpayers of the United States have ever made! If the government or the Federal Reserve could find just 80 more such investment opportunities, taxpayers would be completely debt-free!

. Objective analysis of the history of the financial wherewithal of the insurance industry as opposed to the banking industry would seem to indicate that the former has been less volatile and has caused less damage in financial downturns. Since the banking industry has done more damage and since you have been more involved in supervising banks for a century (you regulated bank holding companies even prior to Dodd-Frank and certainly during the mortgage risk exposure build up prior to 2008) this does not bode well for the Fed (neither does the lousy economic growth pattern of the last decade). The US insurance industry has flourished since Benjamin Franklin set up the first insurer, The Philadelphia Contributorship, in 1752. Several of the insurers operating today have been around for 150 or more years (e.g., Travelers, Hartford, Met Life, John Hancock, Northwestern Mutual, New York Life, Prudential, etc.). Several others have been operating for about a century including AIG for that matter! Contrary to mythical claptrap, the industry has not changed drastically. Insurance was always global insofar as annuities were established more than two millennia ago, life insurance existed in ancient Egypt and China, marine insurance existed almost as early as trade amongst cultures was established in ancient Greece and its environs. The idea that all of a sudden insurance is new and global interactions are new is myth. Moreover, even the fact of holding companies is not new (I was around when the New York Insurance Department formulated the Holding Company Act-in 1969)! The US industry has flourished over the many decades and guess what-without risk management, without CROs, without group capital requirements, without regulatory involvement by the Fed. How can that have occurred?

. It is unclear exactly what your goal is. Dodd-Frank does not define what financial stability actually means. There is no sentence that starts: "Systemic risk means. ." The closest one comes is in Section 113(a)(1) which state:"(a) U.S. NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS. (1) DETERMINATION. The Council.may determine that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States." (Emphasis added) How much of a threat is omitted. Any threat at all? A one hundredth of one percent threat?: A one percent threat? A 50 threat? And what does "stability" mean? That GDP grows at a steady .8% per annum? That would be "stable" but not very good.

. As an additional insight, the insurance industry can make money, noting that making money is the prime function of an insurance company, particularly one owned by capital providers, in one of three ways, namely, underwriting, investing or engaging in fee for service enterprises. Since the industry is highly competitive and uses the same basic cost information (i.e., mortality, morbidity and non-life, non-health loss occurrence experience), material differences in basic loss costs constructs cannot exist as between competitors (note the Met Life reconstruction effort). I can't be saving that $476 or $573 continuously by changing my auto insurance carrier ad infinite or can I? Some companies may be more efficient than others allowing for a price differential. But all companies, despite what they may think, cannot be more efficient than all other companies in their underwriting prowess. It's like credit spreads. If the credit spreads are exactly accurate, then they has to be winners and losers. If all are winners or all are losers then the spreads are not accurate. If the investment climate remains as is, i.e., low if any interest rates and credit spreads and highly volatile equity markets with extreme risks due to lack of economic growth, insurers selling underwritten products that require investment income to fund future cash outflows do not have a rosy future ahead of them (note the average annual growth in equity values from mid-2017 through today). The Dow is less than 20% above where it was nine years ago! Do you think insurance products priced in the 1990s were predicated on there being a period of almost a decade and half of near zero interest rates? That only leaves fee for service as an area ripe for profit (note Met Life again). And you want to add cost to the system without a demonstrated quantified benefit? Seems pretty maniacal to me. Especially as the industry employs 2 million people in its various facets (i.e., including intermediaries). Do you think capital providers will be rushing to invest in insurers because you say they need more capital and risk management to prevent exactly what? By the way, instead of this project, focus on how you can get out of the way, allow the economy to grow, allow interest rates to flow back to the traditional values of the cost of money and allow savers and retirees, who have arrived at a stage in life, where they need no longer take equity market risk, to "de-risk" and obtain reasonable cash flows from their savings without worry (you've essentially killed off the fixed annuity market).

. Think of it this way: You project out the exact amount of so-called future taxpayer bailout you are attempting to avoid by installing today requirements regarding capital and risk management resources which cost the present value of that amount. You get it exactly right! What is accomplished? Nothing is accomplished. You just prefunded the bailout. So who pays the cost. Not taxpayers? Well aren't taxpayers and policyholders essentially the same constituency. However, in fact, some policyholders become subject to a surtax since way more than 50% of the citizens pay for some form of insurance but only about 50% pay taxes! To disprove this thesis, you would need to set forth that the incurred costs of your proposal(s) are less than the present value of the future bailout. Have you done that? Can you do that? I'm from New Jersey-show me.

. I could give chapter and verse relative to your detailed questions but since I don't think this is a worthwhile project and that both proposals should be rejected (as well as those emanating from other sources), I will refrain from regaling you further. You have important fish to fry; this "ain't" one of them.