

**Meeting Between Federal Reserve Board Staff
and Representatives of American Insurance Association
February 9, 2011**

Participants: Michael Gibson, Mark Van Der Weide, Diane Fraser, Maria Perozek, Missaka Warusawitharana, Paige Pidano and Christine Graham (Federal Reserve Board)

J. Stephen Zielezienski (American Insurance Association) and
Gilbert Schwartz (Schwartz & Ballen LLP)

Summary: Federal Reserve Board staff met with representatives of the American Insurance Association (“AIA”) to discuss systemic risk regulation in light of the new authority provided to the Financial Stability Oversight Council (“FSOC”) and the Federal Reserve Board under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act. AIA’s representatives discussed their views on applying the systemic risk criteria set forth in the FSOC’s Notice of Proposed Rulemaking “Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies” to the property and casualty insurance industry.

Additional materials distributed at the meeting are attached.



February 9, 2011

Via Electronic Submission

The Honorable Timothy F. Geithner
Chairperson
Financial Stability Oversight Council
1500 Pennsylvania Avenue, N.W.
Washington DC 20220

Re: Supervision and Regulation of Certain Nonbank Financial Companies

Dear Secretary Geithner:

The American Council of Life Insurers, the American Insurance Association and the Reinsurance Association of America appreciate the opportunity to comment on the Financial Stability Oversight Council's (the "Council") Notice of Proposed Rulemaking ("Proposed Rule"), which describes the criteria that the Council will apply in considering whether to designate nonbank financial companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA").¹

ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. AIA represents approximately 300 major U.S. insurance companies that provide all lines of property-casualty insurance to U.S. consumers and businesses, writing more than \$117 billion annually in premiums. The RAA is the leading trade association of property and casualty reinsurers and life reinsurers doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross-border basis. As financial companies, our members have a significant interest in the provisions of the Proposed Rule.

ACLI, AIA and the RAA are writing to request that the Council defer further action on this matter as applied to insurers until such time as the independent member of the Council having insurance expertise is appointed by the President and confirmed by the Senate, and the Director of the Federal Insurance Office is appointed by the Secretary of the Treasury. ACLI, AIA and the RAA also request that the Council stay further consideration of any Council action as may be applied to insurers until it has proposed qualitative and quantitative standards that it may use to assess insurers, and has provided the insurance industry and the public with an opportunity to comment on such standards. As discussed in greater detail below, ensuring that the appropriate insurance expertise is in place to inform the rulemaking *and* providing a transparent process that allows for public comments on the quantitative and qualitative standards that will be applied by the Council are necessary components to the successful implementation of these critical provisions of the Dodd-Frank Act.

¹ 76 *Fed. Reg.* 4555 (January 26, 2011).

BACKGROUND

Section 113 of the DFA authorizes the Council to determine that a U.S. or foreign nonbank financial company be supervised by the Federal Reserve Board (the “Board”) and be subject to enhanced prudential standards if the Council determines that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness or mix of its activities could pose a threat to the financial stability of the U.S.² The DFA sets forth ten specific factors for the Council to consider, including the extent of the company’s leverage, off-balance sheet exposures, transactions and relationships with other significant financial companies, and any other risk-related factors that the Council regards appropriate.³

The Council noted in the *Federal Register* preamble that, in response to its October 2010 advanced notice of proposed rulemaking (“ANPR”),⁴ commenters stated that the Council’s determinations should be based upon a combination of qualitative and quantitative considerations.⁵ Moreover, the Council stated that commenters generally agreed that analytical frameworks for designation should be tailored to the type of industries in which the firms operate. In this regard, several commenters advised that the Council should avoid imposing bank-centric standards on other industries. It was also suggested that the Council focus its attention on unregulated activities and firms, and many commenters urged that companies that are already subject to consolidated supervision or heightened reporting requirements should be excluded from designation by the Council. The Council indicated that it was generally noted by commenters that some form of risk-weighting should be used in assessing the scope, size and scale of nonbank financial companies.⁶ Commenters also suggested various approaches, standards and tools for the Council to consider in assessing a nonbank financial company’s interconnectedness, leverage and funding sources.⁷ The Council was also asked to define terms such as “material financial distress” and “financial stability.” Finally, commenters also suggested other risk-related factors for the Council to consider, such as the legislative intent of Congress regarding the treatment of certain industries, cyclicity and the burden of designation on financial companies.

DISCUSSION

The Council proposes rules to implement its authority to subject financial companies to Board supervision and enhanced prudential standards by establishing regulatory considerations that are virtually identical to the language of section 113 of the DFA.⁸ Moreover, the Council proposes a framework for assessing systemic importance based upon six broad categories, which are aligned with the same considerations set out in section 113.

The Council states that firms that are larger, that provide critical financial services for which there are few substitutes, and that are highly interconnected with other financial firms or markets are more likely to pose a systemic threat to the financial stability of the U.S. if they fall into financial distress. The Council indicates that it will apply criteria such as leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny to assess how vulnerable a company is to financial distress. The Council states that firms that are highly leveraged, have a high degree of liquidity risk or maturity

² DFA §§ 113(a)(1), (b)(1).

³ DFA §§ 113(a)(2), (b)(2).

⁴ 75 *Fed. Reg.* 61653 (October 6, 2010).

⁵ 76 *Fed. Reg.* at 4556.

⁶ 76 *Fed. Reg.* at 4557.

⁷ 76 *Fed. Reg.* at 4558.

⁸ 76 *Fed. Reg.* at 4563. *See, e.g.*, proposed rule 12 C.F.R. §§ 1310.10, 1310.11.

mismatch, and are under little or no regulatory scrutiny are more vulnerable to financial distress and therefore pose a greater systemic threat to the financial stability of the United States.

To evaluate nonbank financial companies in each of the six categories, the Council states that it will use quantitative metrics where possible, and its judgment, to determine whether a firm should be designated as systemically important and supervised by the Board.

Public Comment on Applicable Standards is Necessary

ACLI, AIA and the RAA are concerned that notwithstanding the extensive comments provided to the Council in response to its October ANPR, nothing in the actual language of the Proposed Rule provides nonbank financial companies with any guidance as to the standards that the Council intends to apply in carrying out its functions to determine whether or not to subject a financial company to the Board’s supervision and to enhanced prudential standards.⁹ For example, the Council chose not to define such basic terms as “material financial distress” and “financial stability,” despite the request of commenters for working definitions of these important terms. Moreover, the Council concludes that firms that are “larger,” “highly interconnected” and “highly leveraged” may pose greater systemic threat to financial stability, yet the Proposed Rule gives no hint as to what standards are to govern the application of these characteristics to nonbank financial companies. These terms, of course, will have different meanings in different industries. The Council’s failure to provide meaningful standards that it will apply in making its assessments is particularly troubling in view of the statement that it expects to begin assessing the systemic importance of nonbank financial companies under the proposed framework shortly after adopting a final rule.¹⁰ It is difficult to provide comprehensive comments on the Council’s Proposed Rule without having the opportunity to review and comment on the metrics the Council states it will rely upon, as well as the conceptual foundations that underlay its judgment. Accordingly, we request that the Council delay final action on its Proposed Rule at this time. We recommend that the Council initiate the process of developing meaningful standards that reflect the unique aspects of the insurance industry and seek public comment on those standards to the extent they are utilized in the determination process arising from section 113.¹¹

A Delay Is Necessary Until All Insurance Representatives Are Appointed

A delay in the Council’s action on the proposal is further warranted in view of the two vacancies in the Council’s membership for the independent voting member who possesses insurance expertise, as well as the Director of the Federal Insurance Office, who has yet to be appointed.¹² The importance of having Council members with insurance expertise participate in the Council’s deliberations during its formative period cannot be overstated. As Congressman Paulsen, the sponsor of the amendment that addressed the role of the State insurance regulator representative and the Director of the Federal Insurance Office as members of the Council, stated during the House’s consideration of the DFA:

⁹ In addition to Board supervision and enhanced prudential standards, nonbank financial companies so designated by the Council are required to periodically file a plan for rapid and orderly resolution in the event of material financial distress or failure. DFA § 165(d).

¹⁰ 76 Fed. Reg. at 4561.

¹¹ ACLI has engaged Oliver Wyman, a leading international management consulting firm, to assist it in developing specific standards that reflect the unique nature of the life insurance industry. ACLI plans to submit its recommendations to the Council for its consideration.

¹² Missouri Insurance Director John Huff has been designated as a nonvoting member of the Council by the State insurance commissioners to fill the designated third seat for insurance.

I believe that it is important to ensure that the Federal insurance office and other state regulators have a seat at the table for any deliberations that impact the consumers they protect and institutions they regulate. If these institutions are going to be responsible for paying into the bailout fund, it is only fair that their concerns are represented.¹³

We do not believe that the insurance members on the Council that are awaiting appointment should take a back seat to members who have already been designated. Accordingly, we strongly believe that it would be contrary to Congressional intent and do a disservice to the Council and to the insurance industry for the Council to proceed without the full complement of members who are able to provide critical input to the Council and participate in the Council's important decisions that will affect the insurance industry long into the future. It is therefore inappropriate for the Council to set in motion a process before it has had the opportunity to obtain the advice of the voting member with insurance expertise and the Director of the Federal Insurance Office. Accordingly, we urge the Council to defer action on the Proposed Rule until these two members are seated.

AIA, ACLI and the RAA appreciate the opportunity to present their views on the Council's proposal. Given the importance of implementing section 113 in a manner that is fair, open and consistent with the statutory purpose of the DFA, for the reasons stated above, we further request that all standards utilized by the Council and its constituent agencies be subject to public comment before those standards are applied to insurers. Appropriate due process protections need to apply at each stage.

If you have any questions regarding our comments, we would be pleased to discuss them further with you.

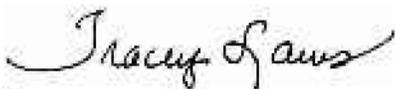
Sincerely,



Julie A. Spiezio
Senior Vice President & Deputy General Counsel
American Council of Life Insurers



J. Stephen ("Stef") Zielezienski
Senior Vice President & General Counsel
American Insurance Association



Tracey Laws
Sr. V.P. & General Counsel
Reinsurance Association of America

cc: Senator Tim Johnson
Senator Richard C. Shelby
Congressman Spencer Bachus
Congressman Barney Frank
William M. Daley
Lance Auer

¹³ 156 *Cong. Rec.* H 14737 (daily ed. Dec. 10, 2009). In fact, one of the statutory functions of the FIO is to assist in the section 113 process. DFA § 502(a)(3).