January 26, 2015

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Resolution of Insurance Companies

Dear Chairman Gruenberg:

The Committee on Capital Markets Regulation (the "**Committee**") recommends that the Federal Deposit Insurance Corporation (the "FDIC") issue formal guidance stating that resolution under the Orderly Liquidation Authority ("**OLA**") established in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**")[1] is not appropriate for insurance companies or their affiliates.

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-seven leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

For an insurance company and its affiliates to be put into OLA, Dodd-Frank requires that 2/3 of the Board of Governors of the Federal Reserve and the Director of the Federal Insurance Office, in consultation with the FDIC, issue a recommendation to the Secretary of the Treasury regarding any actions that should be taken pursuant to Title II and an evaluation of why the applicable bankruptcy law is not appropriate.[2] The Secretary of the Treasury (in consultation with the President) must then determine that the failure of the insurance company and its affiliates under otherwise applicable law would have serious adverse effects on U.S. financial stability and that placing the insurance company and its affiliates into a Title II resolution would avoid or mitigate these adverse effects.[3] Following this "systemic risk determination," the FDIC would be appointed receiver of the holding company of the insurance company.[4]

For an insurance company, a systemic risk determination could be made for one of two reasons. Either the failure of an insolvent insurance company would pose systemic risk or the failure of an insurance company's holding company or non-insurance affiliates would pose systemic risk. The Committee believes that neither case justifies the use of OLA for insurance

[1] 12 U.S.C. §§ 5381-5394 (2012).
[2] Sec. 203(a)(2) of the Dodd-Frank Act.
[3] Sec. 203(b) of the Dodd-Frank Act.
[4] Sec. 203(a)(1)(A) of the Dodd-Frank Act

companies. Insolvent insurance companies should be resolved by state regulators, and insolvent holding companies and non-insurance affiliates should enter bankruptcy.

Insolvent Insurance Company

The Committee believes that a Title II resolution of an insolvent insurance company would not be appropriate, because Dodd-Frank clearly reserves authority to resolve an insurance company with state regulators and the Committee believes that state regulators and state laws adequately protect the claims of insurance policy holders.

According to the Dodd-Frank Act, "if an insurance company is a covered financial company[5] or a subsidiary or affiliate of a covered financial company, the *liquidation or rehabilitation* of such insurance company…shall be conducted as provided under applicable State law."[6] State laws require state insurance regulators to take control of an insolvent or nearly insolvent insurance company by putting it into a receivership.[7] Once in receivership, state insurance regulators have broad authority to liquidate or rehabilitate the insurance company, with the overriding goal being that insurance policyholders receive a full recovery.[8] Therefore, putting an insurance company into a Title II resolution would not provide the FDIC with any additional authorities over the insolvent insurance company.

Dodd-Frank's legislative exclusion of insurance companies from Title II is wise, as state receivership laws sufficiently protect the claims of insurance policyholders. For example, state laws allow state insurance regulators to ring-fence the assets of the insurance company from any cross-claims by non-insurance affiliates or the holding company to ensure that insurance policyholders have adequate recovery.[9] State receivership laws have proven effective in the past. For example, according to state insurance regulators, these receivership authorities guaranteed that the claims of AIG's insurance policyholders were not threatened by the losses of AIG's non-insurance subsidiaries or holding company.[10] Moreover, state insurance regulators had the authority to protect AIG's insurance policyholders from a run by the securities lending counterparties of AIG's insurance subsidiaries.[11] If insurance policyholder claims were to exceed the assets of an insurance company, then each state has a state guarantee fund that would seek to

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[5] Sec. 201(a) (7) defines a "covered financial company" – "A covered financial company is any financial company for which there has been a systemic risk determination pursuant to Title II."
[6] Sec. 203(e)(1) of the Dodd-Frank Act
[7] Congressional Oversight Panel, "The AIG Rescue, It's Impact on Markets, and the Government's Exit Strategy" at Page 118 (Hereafter the COP Report) "State insurance regulators…have to address any insolvent or illiquid insurance subsidiaries through their resolution tools…to the extent that an insurance subsidiary is undercapitalized, state insurance regulators—and state insurance guarantee funds—have to step in."
[8] Federal Insurance Office, U.S. Department of the Treasury, "How to Modernize and Improve the System of Insurance Regulation in the United States," (hereafter FIO Report) at 43, December 2013.
[9] COP report at 155 "State insurance regulators have the ability to "ring-fence" solvent insurance entities to shield them from the parent entity's losses or bankruptcy in order to protect existing policyholders."
[10] COP report at 266.
[11] COP report at 279, The ability of AIG's securities lending counterparties "to collect on their deficiency claims would depend on the actions of the state insurance regulators. If the regulators seized the insurance subsidiaries, the securities lending counterparties would likely have received nothing for their deficiency (or would have received a minimal amount after all of the policyholders were paid in full, a potentially substantial delay). If the regulators did not seize the insurance subsidiaries, the subsidiaries' ability to pay would depend on their financial condition or solvency at the time of the claim."

make certain that insurance policyholders are not impaired.[12] Historically, state guarantee funds have a solid track record in achieving that goal. Even in an extreme case where the insurance policyholders of an insolvent insurance company had claims that exceeded the assets of a state guarantee fund, the state guarantee fund has the authority to levy other insurance companies so insurance policyholders of the insolvent insurance company would be made whole.[13] The protection of policyholders is also strong internationally, as insurance insolvency regimes in foreign jurisdictions are organized to protect policyholder interests. Across the board, foreign jurisdictions allow measured long-term insolvency proceedings to achieve the goals of protecting policyholders, in the same manner as domestic state regimes.

There is, however, the issue of certain *back-up* authorities for the FDIC to play a role in the resolution of an insurance company. According to Dodd-Frank, if 60 days have passed since a systemic risk designation has been made for an insurance company and state insurance regulators have not initiated an action to put the insurance company into an orderly liquidation under state law, then the FDIC may resolve the company under *state law*.[14] Because the Committee believes that the Secretary of the Treasury should not make a systemic risk designation for an insurance company, this back-up authority provision would not come into effect. But even if it did, the FDIC would have to resolve the insurance company under state law.

Insolvent Holding Company or Non-Insurance Affiliates

The Committee recommends that the assets or liabilities of a solvent insurance company not be used to support its insolvent holding company parent or any non-insurance affiliates, because state insurance regulators retain authority over solvent insurance companies and the Committee believes that the bankruptcy of an insurance company's holding company and non-insurance affiliates would not pose systemic risk. Furthermore, we believe an insolvent holding company or non-insurance affiliates should be resolved in bankruptcy and not under OLA because its insolvency will not create systemic risk.

State laws provide state insurance regulators with broad authority to put even a *solvent* insurance company into receivership to protect the claims of insurance policyholders.[15] Once a state insurance regulator puts a solvent insurance company into receivership, state laws ring-fence the insurance company's assets and liabilities, so the FDIC cannot use them to support an insolvent holding company or non-insurance affiliates.[16] In the past, state insurance regulators have often used their broad receivership authorities to protect the assets and liabilities of a solvent insurance company from any bankruptcy claims by its holding company or non-insurance affiliates.[17]

The Committee does not believe that the interconnectedness of an insurance company's holding company and any non-insurance affiliates pose systemic risk. "Asset interconnectedness" is a form of connectedness describing a relationship between financial institutions whereby the failure of one institution may provoke a chain reaction of failures by other financial institutions with direct credit exposures to each other. Many viewed AIG's role in the 2008 financial crisis as

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[12] FIO Report at 44.
[13] COP report at 155, and 263-264.
[14] Sec. 203(e)(3) of the Dodd-Frank Act
[15] See, for example, Tex. Ins. Code Ch. 404.003; 404.053, NY Ins. Code § 7402(e), or COP report at 155.
[16] Id and COP report at 264.
[17] COP report at 155.

an asset interconnectedness problem, because of credit derivatives written by AIG Financial Products and securities lending by AIG's holding company. However, an analysis by the Financial Crisis Inquiry Commission of the financial institutions with the largest securities lending exposures to AIG's holding company and credit derivative exposures to AIG Financial Products (a non-insurance subsidiary) shows that 100% losses on these exposures would *not* have rendered these financial institutions insolvent.[18] This is due to the fact that firms limit, collateralize and hedge the risk of a counterparty default. These self-protection measures have been strengthened by higher capital requirements, counterparty limits and central clearing of derivatives

It is the Committee's view that "contagion," not "interconnectedness," was the primary driver of the 2008 financial crisis. Regulatory efforts to prevent or minimize systemic risk should therefore be aimed at reducing the risk of contagion. This is the approach the FDIC has taken in designing its single point of entry approach to dealing with the resolution of banking firms under Title II. However, putting an insurance holding company or non-insurance affiliate into a Title II resolution would not reduce the risk of contagion. There is little risk of a run on the liabilities of an insurance holding company or non-insurance affiliate, as insurance companies do not own any large broker-dealers or banks. The number of insurance company-owned broker-dealers is largely in decline and will be virtually non-existent in a few years. Over the last few years, a number of large insurance companies have divested their interest in broker-dealers. For example, AIG and MetLife used to own medium-sized broker-dealers, but those have largely been spun off.[19] ING has sold three of its four independent broker-dealers since 2012, while Ameriprise Financial and Hartford Financial Services sold their independent broker-dealers as well.[20] Even if there were concern with the failure of a broker-dealer affiliate of an insurance company, that can be addressed by just putting the broker-dealer in OLA, not the insurance holding company itself. More importantly, contagion is fundamentally stopped through the actions of the lender of last resort and liability guarantees, not by a resolution process.

The Committee stresses that the FDIC should never use the assets or liabilities of an insurance company to lend to or capitalize the holding company or a broker-dealer affiliate — indeed as indicated above it lacks legal power to do so. And conversely, the FDIC does not have to protect against a run on insurance companies themselves—by injecting capital into such companies as it plans to do for banking subsidiaries—since, unlike banks, insurance companies do not have significant runnable liabilities. Furthermore, since the insurance holding company should not be placed into OLA, the Committee believes that increased capital requirements or the imposition of total-loss-absorbing-capital ("TLAC") requirements for the holding company would not be appropriate. While increased capital at the insurance company level may reduce the chance of insolvency and thus provide an added buffer to state guarantee funds, this should be left to the state regulators to determine and should not be incorporated as part of resolution under OLA.

Insurance Subsidiaries of Bank Holding Companies

The FDIC has adopted a single point of entry ("SPOE") approach for bank holding companies ("BHC"), which is designed to keep insolvent subsidiaries operational by injecting

[18] The Financial Crisis Inquiry Report, at 377. See also Hal Scott, "Interconnectedness and Contagion – Financial Panics and the Crisis of 2008." June 26, 2014.
[19] Investment News, "Insurer owned broker-dealers slowly fading away," January 1, 2012
[20] Investment News, "Insurance companies take a step back," January 29, 2012.

them with capital or liquidity from the holding company or other solvent affiliates.[21] Although the Committee supports the SPOE approach, we believe that the Dodd-Frank defers authority over solvent insurance companies to state insurance regulators in a manner that prevents the FDIC from using the assets or liabilities of a solvent insurance company for any purpose, even where these insurance companies are affiliates of bank holding companies.[22] According to Federal Reserve Bank of NY research, U.S. bank holding companies held 479 insurance subsidiaries in 2012, representing slightly more than 1% of bank holding company consolidated assets.[23]

Under SPOE, the FDIC has proposed that operating subsidiaries not be restructured—this approach should extend to insurance subsidiaries as well as banks and broker-dealers.

Conclusion

In conclusion, the Committee believes that a Title II resolution is not appropriate for insurance companies, or their holding company or other affiliated entities. In the case of the insolvency of an insurance company, OLA is not appropriate, because Dodd-Frank clearly reserves authority to resolve an insurance company with state regulators and we believe that state regulators and state laws adequately protect the claims of insurance policy holders. Furthermore, we believe an insolvent holding company or non-insurance affiliates should be resolved in bankruptcy and not under OLA because neither the insolvency of a holding company nor the insolvency of a non-insurance affiliate will create systemic risk. The Committee also recommends that the assets or liabilities of a solvent insurance company not be used to support its insolvent holding company parent or any non-insurance affiliates, because state insurance regulators retain authority over solvent insurance companies and the Committee believes that the bankruptcy of an insurance company's holding company and non-insurance affiliates would not pose systemic risk.

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Thank you very much for your consideration of the Committee's opinion. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), at your convenience.

Respectfully submitted,

R. Glenn Hubbard	John L. Thornton	Hal S. Scott
CO-CHAIR	CO-CHAIR	DIRECTOR

[21] Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76,614 (released Dec. 18, 2013).
[22] *Supra* at 16.
[23] *See* Dafna Avraham, Patricia Selvaggi & James Vickery, *A Structural View of U.S. Bank Holding Companies*, Federal Reserve Bank of New York, found at http://www.newyorkfed.org/research/epr/12v18n2/1207avra.pdf