



Financial Security...for Life.

DIRK KEMPTHORNE

President & Chief Executive Officer

April 12, 2017

The Honorable Mike Crapo
Chair
Senate Committee on Banking, Housing
and Urban Affairs
534 Dirksen Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking, Housing,
and Urban Affairs
534 Dirksen Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the American Council of Life Insurers (ACLI), I am pleased to respond to your request for legislative proposals within the jurisdiction of your committee. Thank you for establishing a process to receive input from public stakeholders that would strengthen financial institutions and in turn help their customers. The proposals I mention in this letter will foster economic growth by helping life insurers, as financial institutions, conduct their business more efficiently.

The American Council of Life Insurers is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, 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. Learn more at www.acli.com.

As long-term investors, life insurers help drive economic growth and provide financial stability. Life insurers are a major source of bond financing for American businesses, holding approximately 20 percent of all U.S. corporate bonds, which fund business expansion, innovation, job growth, and infrastructure. Our bonds have an average maturity of 18 years at the time of purchase. And when the Build America Bond program was introduced in 2009, the U.S. life insurance industry bought nearly one-third of them. Because life insurers make guarantees that often last many decades, they invest in assets that have similar long-term horizons. This kind of asset-liability duration matching is not only a fundamental principle of prudential regulation of insurers, but also positions life insurers to be a powerful source of long-term capital and economic growth. The bonds that life insurers purchase today have an average maturity of more than 18 years. Total investments by life insurers in the U.S. economy amount to \$5.9 trillion.

In addition, the life insurance industry helps 75 million American families protect their financial and retirement security. In 2015 alone, American families received \$328 billion from annuities payments, \$119 billion from life insurance policies, \$18 billion in disability income insurance benefits, and \$9.6 billion in long-term care insurance benefits. Every day, total payments by life insurers to families and to businesses reach \$1.7 billion. Through retirement and insurance products provided by life insurance companies, Americans are better able to plan, save and guarantee their savings for a secure retirement.

American Council of Life Insurers

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To promote increased economic growth and help more Americans achieve financial security, ACLI recommends the following proposals and policies. We believe the proposals below will foster economic growth and produce better outcomes for insurance policyholders. Thank you for your consideration of these proposals, and we very much look forward to working with you and your Committee.

Sincerely,

A handwritten signature in blue ink, appearing to read "Dirk Kempthorne", with a long horizontal flourish extending to the right.

GOVERNOR DIRK KEMPTHORNE

Repeal FSOC's authority to designate insurers as systemically important.

The FSOC process for systemic designations of non-banks has been materially unfair and uneven. Life insurance companies that have gone through the designation process have not received adequate information or explanation of FSOC analysis and decisions. Documents provided by FSOC to insurance companies provide little insight into the basis for designation decisions. These documents typically offer only conclusory statements, unrealistic predictions, and speculations that are unsupported by factual and economic analysis. FSOC has not provided companies with enough information that would allow them to take positive steps to avoid designation, or be de-designated through appropriate action.

A significant issue with the FSOC process has been the extremely inconsistent use of its broad authorities as applied to different sectors of the financial services industry. This problem is best illustrated by the very different approaches taken towards the insurance industry, which has been subject to designation of individual firms, as compared to the asset management industry. In the case of asset managers, FSOC has focused on recommendations for new or heightened standards for specific practices that may pose significant risk rather than singling out firms for designation.

Another significant problem with the FSOC process for non-bank systemic designations of insurers has been its failure to appropriately consider the role of existing primary financial regulators leading to a lack of understanding and recognition of the strong insurance regulatory framework in place through the state-based system. The state-based insurance regime has a long and successful track record of insurance regulation.

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 vigilant in identifying and aggressive in addressing issues of concern that might jeopardize the corporation 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.

One of the explicit statutory requirements the FSOC must consider is the "degree to which the company is already regulated by one or more primary financial regulatory agencies." Contrary to this statutory requirement, the FSOC has not appropriately considered in its designation of insurers the authority and tools available under the state-based insurance regime, including numerous and substantial reforms policymakers have implemented since the financial crisis.

The lack of consideration given to primary financial regulators of insurance has been exacerbated by the lack of insurance expertise and representation on the panel. Of the 10 FSOC voting members, at least seven are primarily banking industry regulators. When either the FSOC Independent Member with Insurance Expertise or the nonvoting state insurance regulator offered dissenting views, they were disregarded and overruled. FSOC also dismissed concerns registered by the then primary insurance regulator in New York state, Benjamin Lawsky, Superintendent of the New York Department of Financial Services, in a letter to Treasury Secretary Jacob Lew in July of 2014.

Clearly, the designations of insurers were largely dependent on banking expertise, not insurance expertise. FSOC's decisions with regard to insurers were bank-centric and not grounded in an accurate understanding of the business of insurance. Life insurers are fundamentally different from banks. FSOC's 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 illustrates its bank-centric mindset for considering insurance firm designations.

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

FSOC's narrow focus on a few individual entities in certain sectors has diverted attention and resources away from its more important role as a broad-sighted macro-prudential overseer of the economy that can identify potential systemic risk in a timely fashion. The enormous resources and time devoted by FSOC to duplicative oversight of a few individual insurance companies has significantly depleted the attention that could be focused on insufficiently regulated or unregulated sectors of the financial economy, where the next crisis is much more likely to arise. 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.

FSOC's insurance regulatory expertise should be significantly increased.

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.

Support Certification and Implementation of the Covered Agreement on Insurance and Reinsurance.

The Covered Agreement on insurance and reinsurance strengthens the competitiveness of U.S. insurers and allows U.S. capital to be invested in the economy and put to work here in the U.S. In the absence of the bilateral Covered Agreement, U.S. companies operating in the EU would be compelled to export and sideline capital to meet costly, duplicative EU regulations. The Covered Agreement blocks extra-territorial application of onerous EU regulations, affirms the strength of the U.S. state-based system of insurance supervision, and keeps U.S. capital at home.

The Covered Agreement resolves outstanding regulatory disputes weighing on insurance markets and provides regulatory certainty to companies operating in both jurisdictions. Before the agreement, each EU member state could impose its own requirements on U.S.-based insurers doing business in that country. That unpredictability and uncertainty resulted in unexpected costs, and undermined the ability of U.S. insurers to compete on a level playing field. ACLI members will benefit from the certainty provided by the Covered Agreement, allowing them to dedicate resources to protecting the financial security of their policyholders.

We urge Congress to support timely certification of the covered agreement by the Administration.

The functions of the Federal Insurance Office (FIO) should be retained and refocused.

The functions of the Federal Insurance Office should emphasize federal efforts on prudential aspects of international insurance matters, including continued participation at the International Association of Insurance Supervisors. Some adjustment to FIO's 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.

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.

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 to avoid conflicting or duplicative regulation.

As the Committee already knows and has affirmed in legislation, insurance companies are not banks and have very different risk profiles and business models than banks. Legislative and 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. We urge the Committee, through its oversight function and in considering legislation, to ensure that prudential regulation is appropriately tailored to the business of insurance.

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.

Life insurers should not be subject to punitive initial margin requirements on uncleared swaps.

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 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.