LEGISLATIVE REVIEW OF H.R. 5059, THE STATE INSURANCE REGULATION PRESERVATION ACT

HEARING

BEFORE THE

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HOUSING AND INSURANCE

OF THE

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LEGISLATIVE REVIEW OF H.R. 5059, THE STATE INSURANCE REGULATION PRESERVATION ACT

Wednesday, March 7, 2018

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND INSURANCE
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Sean Duffy [chairman of the subcommittee] presiding.

Present: Representatives Duffy, Ross, Posey, Luetkemeyer, Hultgren, Rothfus, Zeldin, Trott, MacArthur, Cleaver, Velazquez, Sherman, Beatty, and Kildee.

Also present: Representative Green.

Chairman DUFFY. The Subcommittee on Housing and Insurance will come to order. Today's hearing is entitled, "Legislative Review of H.R. 5059, the State Insurance Regulation Preservation Act."

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Without objection, all members will have 5 legislative days within which to submit extraneous materials to the Chair for inclusion in the record.

Without objection, members of the full committee who are not members of this subcommittee may participate in today's hearing for the purpose of making an opening statement and questioning the witnesses.

The Chair now recognizes himself for 2 minutes for an opening statement.

I want to thank our witnesses for their participation in today's hearing. We will introduce you all in a moment. We are here today to review the proper balance of the Federal Reserve's supervision of savings and loan holding companies (SLHCs) primarily engaged in the business of insurance.

Under Title 1 of the Dodd-Frank Act, the Fed was given supervisory rulemaking authority over SLHCs in addition to its new authority to establish enhanced minimum leveraged capital and risk-based capital requirements for insurers under that structure.

So here is the situation we currently find ourselves in. If you are an insurance company that operates in multiple States, you are likely organized as an insurance holding company. That insurance holding company and its subsidiaries are regulated by the State insurance commissioners. That is easy enough, right?

The United States system of State-based insurance regulatory model has worked well for over 150 years. Let us say you are an insurance holding company and you own a thrift or a bank. Now you must register as an SLHC. One reason an insurer may want a thrift or a bank is to provide other services to their policyholders.

Now, keep in mind that the thrift or the bank also has its own regulator, the OCC (Office of the Comptroller of the Currency). So these two types of entities within the SLHC are already regulated.

As noted earlier under the Dodd-Frank Act, the Federal Reserve now has supervisory authority and access over every subsidiary in that SLHC, whether insurance or whether a bank.

We are now in a system where a company primarily engaged in the business of insurance has three supervisors: The Fed, the insurance regulator, and the OCC. This is just for insurance companies with a thrift and/or a bank. I want to note that Nationwide's testimony today that they are subject to various regulatory bodies under their structure and that should be duly noted and highlighted. It seems to me we can have a better balance in regard to the Fed's supervision authority over an SLHC that primarily are engaged in the business of insurance.

I want to thank Mr. Rothfus for bringing this bill up and we are having a hearing today and a more broad discussion on what the proper regulatory structure should be.

With that, my time has expired.

And I recognize the Ranking Member, the gentleman from Missouri, Mr. Cleaver, for 3 minutes.

Mr. CLEAVER. Thank you. Thank you, Mr. Chairman. Thank you for the hearing.

Thank you for being here with us today.

This bill before us today, H.R. 5059, introduced by Congressmembers Rothfus and Beatty would allow certain insurance savings and loan holding companies to be exempted from group-wide supervision by the Federal Reserve. Instead, they would be primarily supervised on the State level.

And over the past few years, I, along with others on this subcommittee, have often expressed frustration about duplicative supervision and overburdensome compliance. Federal regulation in both the banking and insurance realms should be tailored appropriately.

However, I do need to express my concern with 5059 as currently drafted, because I believe it could go too far in creating some kind of a loophole for large banks. And their goal would be, of course, to avoid any kind of Federal oversight.

Additionally thrifts that are insured by the FDIC (Federal Deposit Insurance Corporation) should be subject to adequate Federal regulation. Though we are now nearing a decade, believe it or not, since the Great Recession, the lessons learned should remain on the forefront of our policy discussions.

Following the 2008 financial crisis and the collapse of AIG, Congress determined that the Federal Reserve would have consolidated oversight of thrift holding and bank holding companies, including insurance savings and loan holding companies.

The Fed now supervises insurance companies that have been designated as SIFIs (systemically important financial institutions), as well as insurance companies that own thrifts. Congress felt that it was important for the Federal Reserve to have the ability to assess the financial stability across all segments of large financial firms, including the parent companies and the subsidiaries.

The goal is to prevent the kind of systematic failures that led to the economic meltdown of 2008. The Federal Reserve, though, primarily a bank-centric regulator, has taken steps to understand the insurance sector. We know this because of its advanced notice of proposed rulemaking for the capital framework for insurance companies under its purview.

So I am hopeful that the witnesses will share their experiences working with the Fed on the insurance capital standards and elaborate on potential areas for improvement.

As this bill has been recently introduced, I plan to use this hearing as a listening session. I am only hoping today that the witnesses can provide enough information that it will expand our appreciation for this legislation.

Thank you, Mr. Chairman.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the Vice Chairman of this subcommittee, the gentleman from Florida, Mr. Ross for 1 minute.

Mr. ROSS. Thank you, Mr. Chairman and thank you for holding today's hearing on this important proposal to improve oversight of the insurance industry by lifting costly and unnecessary regulations and providing our constituents with better financial opportunities at lower cost.

Mr. Chairman, we talk a lot on this committee about unintended consequences. And that is no surprise given that our mandate covers one of the most complicated, interconnected marketplaces ever to exist, the U.S. financial system.

Given this sprawling system, Members of Congress are sometimes liable to say one thing, mean another and ultimately effect unintended and undesired results. That seems clearly to be the case here throughout Dodd-Frank.

Congress repeatedly emphasized the primacy of State regulation in the insurance industry. The drafters took great pains to applaud and preserve the State-based system of regulation, which has served the American people well for decades.

However, as the Dodd-Frank years have worn on, it has become increasingly clear that in some cases this Congress has failed to effect its stated intent and instead created laws that undermine the benefits and efficacy of our State-based regulatory regime.

The story of insurance companies that operate or used to operate thrift holding subsidiaries is a good example of an unintended casualty of Dodd-Frank regulation.

Today we will learn from witnesses who have watched firsthand as the promise of being left alone transformed into new and unprecedented regulations being placed on their businesses. I want to thank Congressman Rothfus and Congresswoman Beatty for their working together on H.R. 5059 to help provide relief.

And I yield back.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the author of 5059, the gentleman from Pennsylvania, Mr. Rothfus, for 2 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman. I want to thank you for calling today's hearing on the State insurance regulation preservation act, H.R. 5059.

I also want to thank my colleague, Representative Joyce Beatty for her hard work on this important issue.

This is commonsense, what I call right regulation. It is a right regulation bill that tailors the supervision of insurance-focused savings and loan holding companies. As many of you know, Dodd-Frank brought savings and loan holding companies under the Federal Reserve's supervision for the first time.

Despite the fact that Dodd-Frank also reaffirmed the State-based model of insurance regulation, a principle that many of us support, the law had the effect of also bringing insurance savings and loan holding companies under the Fed's purview.

These are companies that are overwhelmingly engaged in the business of insurance, but also happen to own thrift subsidiaries. These insurance companies are simultaneously regulated by the Fed and the States.

The lack of clarity regarding how Fed supervision of these insurers could complement rather than supplant State regulation has led to regulatory inefficiency, duplication of effort, and higher compliance costs. All of this cost and complexity eventually impacts consumers through higher prices and reduced access to services.

We recently heard testimony from Rick Means, the President and CEO of Shelter Insurance Company. In Mr. Means' testimony he described how Shelter was ultimately driven to close its small bank since Fed supervisory requirements added more than $1 million to their compliance burden.

We will hear a similar account today from Mr. Bock. Means wrote that, quote, "expensive new Federal supervision did nothing to protect consumers and instead worked to reduce competition and deprive consumers of banking options."

Our bill addresses this issue by ensuring that insurance savings and loan holding companies that meet State and Federal capital standards are supervised on a day-to-day basis by their State regulators. The Fed will serve as a backstop regulator, and it will be empowered to step in and take a more hands on role if one of these companies does not satisfy its capital standards.

Meanwhile, the Office of the Comptroller of the Currency will retain its authority over thrift subsidiaries. Again, this is a commonsense, targeted, right regulation that will provide greater regulatory clarity and efficiency and reduce unnecessary compliance burden.

I thank the Chairman, and I yield back.

Chairman DUFFY. The gentleman yields back.

We now recognize our panel of three witnesses. Our first witness today is Mr. Michael Mahaffey, Chief Strategist and Risk Officer for Nationwide Mutual Insurance Company. Welcome.

Our third witness is back for, I believe, a second round and one of our frequent presenters, Mr. Daniel Schwarcz, Professor at the University of Minnesota Law School. Welcome.

And for the introduction of Mr. Bock, an Illinois native, I want to look to the gentleman from Illinois, Mr. Hultgren, for that introduction.

Mr. HULTGREN. Thanks, Chairman. It is a pleasure to welcome Kurt Bock, CEO of COUNTRY Financial. He has served as CEO for the last 6, 7 years, oversees about 5,000 employees that they have there. They meet the needs, financial needs and insurance needs of almost a million customers.

Also grateful for his service; served in our Air Force for 28 years, was a colonel, I believe. Is that correct? So Colonel Bock now is CEO of COUNTRY. He also is Chairman of the Property Casualty Insurance Association of America Board of Governors. So grateful for his work there.

And also was appointed back in November 2015 to the Federal Advisory Committee on Insurance by the Director of the Federal Insurance Office.

So Illinois has some challenges. One thing we do well in Illinois is insurance, and so I am so grateful for COUNTRY and other companies that are in Illinois as well. But we just want to welcome Mr. Bock, Colonel Bock, being with us here today.

And thank you, Chairman. I yield back.

Chairman DUFFY. Illinois' challenges, including football.

All Right. Our witnesses in a moment will now be recognized for 5 minutes to give an oral presentation of their written testimony. Without objection, the witnesses' written statements will be made part of the record following their oral remarks.

Once the witnesses have finished presenting their testimony each member of the subcommittee will have 5 minutes within which to ask the panel questions.

On your table you will note there are three lights. The green means you are a go. The yellow light means that you have 1 minute remaining. And if the light turns red, that would mean that the time is up. The microphones are sensitive to please make sure you are speaking directly into them.

And with that, we will now recognize Mr. Mahaffey for 5 minutes.

STATEMENT OF MICHAEL MAHAFFEY

Mr. MAHAFFEY. Thank you. Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee, thank you for the opportunity to appear before you today.

My name is Michael Mahaffey, and I am the Chief Strategy and Risk Officer for Nationwide Mutual Insurance Company. I am testifying on behalf of Nationwide, but also represent a diverse group of insurers that, like Nationwide, are subject to both State insurance holding company supervision and Federal Reserve holding company supervision due to their ownership of a thrift.

I am here today to testify in support of H.R. 5059 and would like to thank the bills' sponsors, Congressman Rothfus and Congresswoman Beatty.

As Nationwide's Chief Strategy and Risk Officer, I am responsible for our business strategy and enterprise risk management program. In these capacities I have had the opportunity to engage directly with the Ohio Department of Insurance and with the Federal Reserve examination teams on numerous occasions.

Therefore, I believe I can offer a helpful perspective on the inefficiencies in the supervisory environment faced by Nationwide and other insurance SLHCs and how H.R. 5059 can maximize supervisory efficiency while avoiding gaps in supervision. Nationwide is an A+ rated diversified financial services company offering property and casualty insurance, financial services, and banking products and services. We are highly regulated across all aspects of our business. Nationwide is registered as an insurance holding company system in the various systems where it is domiciled insurance companies with the Ohio Department of Insurance serving as the lead State supervisor of the holding company system.

By virtue of its ownership of Nationwide Bank, a thrift institution representing less than 3 percent of Nationwide's total assets, Nationwide is also registered as an SLHC and subject to an additional layer of holding company supervision by the Federal Reserve.

We support appropriate levels of supervision and regulation. We are not seeking to eliminate the role of the Federal Reserve in ensuring our safety and soundness.

Rather, we seek to ensure that our supervisory regime: One, provides an appropriate balance between the roles of the Federal Reserve and the State insurance supervisors; two, is proportional and tailored to the risk faced by organization; and three, allows us to focus on the risks that are most material to our organization given our business composition. We believe that H.R. 5059 achieves these goals.

Despite significant supervisory and regulatory cost, Nationwide purposefully opted to continue to offer competitively priced, reliable banking products. These products and services create additional value for the members we serve.

As an example, Nationwide Bank has created innovative solutions to deliver immediate access to insurance funds for our members in the wake of natural catastrophes. Whether utilizing the prepaid claims cards in the aftermath of the Joplin tornadoes or supplying emergency debit cards to customers in Northern California wildfires, who had literally lost everything.

These solutions provide access to critical funds precisely when they are needed most. In the 7 years that we have been subject to Federal Reserve supervision, we have found Federal Reserve examiners to be dedicated public servants who consistently strive to work collaboratively and thoughtfully with us.

We also appreciate the insurance policy team led by Tom Sullivan at the Federal Reserve Board in Washington, which has provided invaluable expertise on insurance and has been equally open and collaborative in working with us.

However, despite the sincere efforts of these professionals at the Federal Reserve, our current supervisory environment remains unnecessarily inefficient in ways that Congress did not intend. As my written testimony highlights in greater detail, there are several examples of instances where Federal Reserve holding company supervision has produced unintentional inefficiencies and redundancy vis-à-vis State supervision.

These include overlapping statutory responsibility to examine the operating and financial conditions of the group, duplicative examinations, inconsistent supervisory regimes or regulatory standards, overlapping authority to require corrective actions, to name a few.

Due to the intensive nature of Federal Reserve supervision, Nationwide's Board of Directors and senior management spend a substantial amount of time and resources reviewing, analyzing, and implementing Federal Reserve supervisory guidance that was designed by bank regulators for banks to manage bank-centric risks.

Further, we devote a substantial amount of time and resources responding to examinations and information requests related to bank-centric supervisory guidance.

These resources would be more appropriately devoted to our most material and relevant insurance risks, which are directly within the purview of the State insurance departments.

I would like to now turn to our support for H.R. 5059 and the appropriateness of this legislative solution. We do not believe that in passing Dodd-Frank, Congress intended to force insurance companies to sell their thrifts.

We also do not believe that Dodd-Frank intended the Federal Reserve to place the same supervisory demands on a $230 billion insurance company with a $7 billion thrift which is already subject to extensive State insurance holding company supervision, as on a $230 billion bank holding company predominantly engaged in banking and other financial activities.

We greatly appreciate Congress' longstanding commitment to the State system of insurance regulation and the thoughtful, bipartisan approach this body has taken on the issues in the past, including the passage of the 2014 Insurance Capital Standards Clarification Act.

H.R. 5059 will work in concert with that act by, one, allowing the Federal Reserve to monitor solvency at the insurance SLHCs by imposing capital standards, two, preserving the Federal Reserve's ability to examine puerile non-regulated entities and to monitor and address those risks through its relationships with primary prudential regulators of those insurance holding companies, and three, provide the Federal Reserve the ability to step in if reasonably necessary using its emergency authority.

Mr. Chairman, in closing, I would like to add that it is critically important to Nationwide and I know to all members of this subcommittee that the legislation address regulatory inefficiencies without creating any regulatory gaps or inequities.

We believe that a bipartisan solution to this issue is critical. And while we support the legislation in its current form we also support necessary changes to improve the bill and increase its bipartisan support.

We look forward to providing additional input as the process unfolds, and we greatly appreciate the opportunity to testify today.

[The prepared statement of Mr. Mahaffey can be found on page 48 of the Appendix]

Chairman DUFFY. Thank you, Mr. Mahaffey.

Mr. Bock, you are now recognized for 5 minutes for your oral presentation.

STATEMENT OF KURT BOCK

Mr. BOCK. Thank you. Mr. Chairman, Ranking Member and members of the subcommittee, my name is Kurt Bock the Chief Executive Officer of COUNTRY Financial. I appreciate the opportunity to testify on behalf of the Property Casualty Insurers (PCI) Association of America, which represents 1,000 insurers and reinsurers providing insurance products to families, communities, and businesses around the world.

COUNTRY is a mid-sized financial company from America's heartland that was formed by a group of farmers in 1925 and provides home, auto, business, and life insurance, as well as retirement investments and education funding for our customers.

COUNTRY Financial has always had an A.M. Best rating of A+ or superior. Most importantly, our top priority is always our customers. And we assess any regulatory changes or proposals through their lens.

State-based insurance regulation of COUNTRY effectively oversees all aspects of our insurance operations. To support our customers' needs for trust, service, and investment management, COUNTRY maintains a very small thrift.

After the Dodd-Frank Act, the Federal Reserve Board assumed supervision of our entire insurance holding company based on our very small depository institution that accounted for only 0.2 percent of COUNTRY's total assets and had no transactional deposits or loans.

While the Federal Reserve staff are exceptionally professional, the endless discovery questionnaires and onsite visits to oversee every corner of our operations consumed roughly 25 percent of our risk management, internal audit, and compliance staff time. COUNTRY had to engage both inside and outside counsel in responding to requests for information that added layers and layers of documentation reporting beyond our current SEC (U.S. Securities and Exchange Commission), FINRA (Financial Industry Regulatory Authority), OCC, and State regulatory requirements.

The additional layers of regulatory oversight threatened to significantly distract us from serving our customers, even though there were no material changes that were required or made as a result of what was an enormous amount of red tape with no real rationale or benefit to our customers or the broader company.

We requested deregistration of our savings and loan holding company in 2015 and were released from the Federal Reserve's supervision in 2017. Even though COUNTRY is no longer subject to Federal Reserve Board oversight, we hope that sharing our experience will help Congress right-size Federal involvement in insurance.

Numerous PCI members have had to divest their small depository institutions that were serving customers and adding synergies to their operations because of increased supervisory cost. Quite simply, the juice was not worth the squeeze, and that clearly was not the intent of Dodd-Frank.

Does Congress really want the Federal Reserve to allocate their resources duplicating State oversight of Main Street insurance companies, particularly when the track record of insurance solvency in the last several financial crises compares very favorably with Federal oversight.

Last year, consumers suffered perhaps the worst insured loss year in U.S. history including record hurricanes, wildfires, earthquakes, and tornadoes, but the insurance industry rose to the challenge. Customer satisfaction with homeowners insurers has never been higher. And the industry's financial strength is similarly at record highs.

As insurers we faced our 1-in-100-year crisis and our companies and regulatory system emerged with record consumer satisfaction and solvency. We fully respect the integrity of the Federal Reserve in carrying out its new responsibilities, but we do not believe Congress truly intended to create an additional layer of intensive Federal insurance supervision.

After years of assurances that that Federal oversight will be proportional, it is clear that further legislative direction is required.

The legislation by Representatives Rothfus and Beatty clarifies the Congressional intent of Dodd-Frank and the growing recognition that Federal Reserve oversight of insurance holding companies needs to be coordinated with State insurance regulators and appropriately tailored and limited to the Fed's unique mission.

Just as COUNTRY decided that the excessive resource cost of Federal oversight did not support our core mission of serving our customers, Congress might recognize that requiring the Fed to be a duplicative regulator for insurers does not well-serve its core mission.

H.R. 5059 would go far in eliminating this unproductive duplication and would assure robust and coordinated State and Federal regulation that is both effective and efficient. Accordingly, PCI and COUNTRY look forward to working with policymakers to finalize and enact H.R. 5059.

I thank you for the opportunity to testify today.

[The prepared statement of Mr. Bock can be found on page 34 of the Appendix]

Chairman DUFFY. Thank you, Mr. Bock.

The Chair now recognizes Professor Schwarcz for 5 minutes.

STATEMENT OF DANIEL SCHWARCZ

Mr. SCHWARCZ. Thank you very much, Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee. I am very sympathetic to the goals of this bill, which are indeed to reduce regulatory compliance burdens on various firms that are already well-regulated by the States.

But I also have a number of substantial concerns about this bill that I want to air in my brief oral testimony today and that I also go into at some length in my written testimony.

The first point I want to make in my oral testimony is that the bill actually goes way further than many of the statements that have been made today. And that is because of how it is drafted.

The bill creates a new type of financial institution that hasn't been recognized before in regulatory and statutory language and that is an insurance savings and loans holding company. It then subjects that company to reduced regulation compared to other savings and loans holding companies.

This inevitably creates the risk of regulatory arbitrage or as one of you mentioned earlier, unintended consequences. And I want to give you an example of that right now to start off my testimony.

Under the bill's language, any bank that wants to avoid Federal scrutiny could simply make its top holding company an insurance company. Get a license for that company to write insurance. Once it did so, under the bill's definition, it would be classified as an insurance savings and loan holding company because its top tier holding company would, in fact, be an insurance underwriting company under the language of the bill.

That is clearly not what is intended by the bill, but it is a result of how the bill is currently drafted. So I would suggest, one, that this should be clarified in the bills' language, but two, that this points to a broader concern with the bill that by creating a new type of regulatory entity that is subject to less stringent regulation than other types of similarly situated regulatory entities, it inevitably creates the risk of regulatory arbitrage.

Second, I want to clarify the statements that have been made that Dodd-Frank somehow radically changed the regulation that insurance savings and loans holding companies face. In fact, while it did transfer supervisory authority to the Fed, it was the case before 2008, well before 2008, that any entity that owned a bank was subject to Federal supervision.

And the group level supervisor for entities, including insurance companies that held depository institutions, was the OTS (Office of Thrift Supervision). It is ironic now that this bill seeks to eliminate Federal oversight over such entities, given that a big part, probably the primary reason why AIG failed, was OTS' failure to exercise its effective group level oversight.

That is why Dodd-Frank transferred supervisory authority over savings and loan holding companies, all savings and loans holding companies, to the Fed in a way that wouldn't result in regulatory arbitrage. Dodd-Frank created a simple and easy rule.

If you own a bank you will be regulated at the Federal level at the holding company level and there is no choice about who your regulator will be. This bill undermines that.

Third, there is a reason why until this point for decades we have always maintained that if you own a bank, if you are a financial conglomerate that owns any FDIC-insured institution you must be regulated at the holding company level.

That is because if you own an FDIC-insured institution, you have a unique privilege, a Federal guarantee of your creditors. That creates unique risks to American taxpayers and to the Federal Government. And a core goal of banking regulation is to manage those risks. Banking regulation accomplishes that by regulating both the bank and the holding company.

If you now eliminate Federal oversight of any financial conglomerate that owns a bank, you create the risk that we are now not just going to have small FDIC-insured institutions and savings and loans holding companies, but that we are going to expose the Insured Depository Fund to heavy losses that are actually a result of its non-bank affiliates.

The final point I want to make is that while it is the case that State insurance oversight is generally strong with respect to the individual entity, the core goal of State insurance regulatory oversight is not group regulation. In fact, insurance group regulation really, for all intents and purposes, didn't even exist until 2008.

So the notion that we are relying on some tried and true regulatory system at the insurance level at the holding company level is simply false. It is a new regime that has yet to be tested. And I think it is a mistake to eliminate Federal oversight on the assumption that it will work well in the next crisis.

[The prepared statement of Mr. Schwarcz can be found on page 58 of the Appendix]

Chairman DUFFY. The gentleman yields back.

A little out of order, but one of the authors of this bill, Mrs. Beatty from Ohio, had a little traffic on the way in, so I want to recognize her for 2 minutes for her opening statement.

Mrs. BEATTY. Thank you, Mr. Chairman and Ranking Member, but let me first thank you for allowing me this opportunity. And my delayed arrival was because, again, a bipartisan event was being held. Congresswoman Kathy McMorris Rodgers joined other leaders as we saluted leader Pelosi for her gavel and suit going into the Smithsonian this morning

But let me say to our witnesses, thank you for being here.

And to my colleague Mr. Rothfus, who I had the pleasure to work with on a bipartisan basis to advance this bill through the Congress.

It is always a pleasantry to welcome our witnesses, but today I take special honor in having someone here from my district, and thank you, Mr. Mahaffey for being here.

In my opinion, this bill simply seeks to right side the excessive burden of regulation placed on insurance savings and loan holding companies compared—and this is really important—compared to the risk they pose to financial stability.

None of these companies has ever been designated by the Financial Stability Oversight Council (FSOC) as posing a risk to the financial stability of the United States' economy, yet they face similar regulations by the Federal Government as if they were, all because of the way they are structured.

There is no reason, in my opinion, why a smaller insurance company like Ohio-based Westfield Insurance Group should face more regulations than some of the larger insurance companies in the country due to the fact that they have a small depository institution. For me, it just makes no sense.

Now, this is a bipartisan bill and I am reasonable so I look forward to hearing from the witnesses on their experiences as insurance savings and loan companies and ways to improve the bill.

Thank you, and I yield back.

Chairman DUFFY. The gentlelady yields back.

The Chair now recognizes himself for 5 minutes.

I just want to be clear on a couple of things. There has been in this committee a lot of debate about Dodd-Frank at different levels, but I don't think anyone says Dodd-Frank is perfect. And I think this is a recognition that there could be some tweaks and modifications to make it work better.

And that is why we have a bipartisan bill to look in and make some slight modifications. And I think this is an example of thoughtful bipartisan brainstorming.

And I am sure that both sides are open to good ideas, whether it is from the panel or from other members on the committee to tweak or modify to make the bill even better.

And I would note that the Ranking Member made a comment about loopholes for big banks. I don't think that is the intent of anybody on this committee. And if there is an issue with that I think we could all work together to address that concern that the Ranking Member may have.

But I want to be clear on the way this bill works, and maybe to Mr. Bock? With the bank that is under the holding company, is there any entity that would regulate the bank under this bill 5059?

Mr. BOCK. Well, the bank is regulated by the OCC.

Chairman DUFFY. It is regulated by the OCC, right, so it is still going to be regulated, right?

Mr. BOCK. Yes, sir.

Chairman DUFFY. We feel like the OCC is a pretty good regulator?

Mr. BOCK. OCC has been a very good regulator.

Chairman DUFFY. I would agree. So let us look at the insurance companies that fall underneath the holding company. Would they be unregulated under this structure of this bill?

Mr. BOCK. They remain regulated, as they are today, by our State insurance departments.

Chairman DUFFY. But the State regulators, and so have they been pretty effective regulators over the last 150 years?

Mr. BOCK. They have been very effective and I would add that they continue to add to their toolsets and in terms of risk management and being able to look at our own risk. So yes, very effective.

Chairman DUFFY. And under this bill the Fed would still have a role at looking at and regulating the holding company. Is that correct?

Mr. BOCK. Absolutely. The bill continues to provide for that.

Chairman DUFFY. And so we have three great regulators who are taking a piece of the pie, who know how to regulate, have been successful in the regulation, in regulating different pieces of different businesses or industries, but it is fair to say we are trying to eliminate duplicative regulation. Is that fair to say, Mr. Mahaffey?

Mr. MAHAFFEY. Yes, I would concur with that.

Chairman DUFFY. OK. And so if you heard Professor Schwarcz's testimony and his concerns about it, and I think he always gives wise and smart testimony. I don't always agree with it, but would you agree with his assessment on the dangers posed by this bill?

Mr. MAHAFFEY. Well, I think he raises good points and I share your comments and your perspective that there is no intention here to create any loophole that would allow for an entity that is unaffected by this to somehow get into this and create a small insurance entity that stands above a big bank.

So I think anything that can be explored to tighten that loophole we would be in support of. That is clearly not the intent of this.

Chairman DUFFY. Right.

Mr. MAHAFFEY. And I think you said this well. This is not a matter of us seeking to eliminate the role of Federal supervision. This is a matter of sequencing and right-sizing it, recognizing what we would consider to be the primary role of the State insurance departments in regulating that insurance entity.

So I think you summarized it well. At the bank level there would be the OCC, who supervises the bank. At the insurance holding company level that is comprehensive and does now include both legal entity and consolidated responsibilities for supervision, that would fall to the insurance departments.

And then the Fed would remain in the ability to monitor, receive information, receive information from the insurance departments as well as the insureds and have the ability to understand whether there are any supervisory gaps within that insurance holding company system and reinsert themselves if those were the cases.

Chairman DUFFY. And I want to be clear on one point because I think this was a smart number, but you guys can tell me if you think I am wrong, but this is not a new regulatory regime for a bank structure that will buy an insurance company held under the holding company. You have to have 75 percent of your assets under the holding structure in the insurance business.

Mr. Bock, is that your understanding?

Mr. BOCK. Absolutely. You would have to buy a lot of insurance companies in order to exceed that threshold.

Chairman DUFFY. And I would just—maybe I will read from page 2. It says, "A savings and loan holding company that held 75 percent or more of its total consolidated assets in an insurance underwriting company or insurance underwriting companies."

And so I think that part was pretty clear. I only have a couple of moments left and maybe other people will get to this. I do think a point that is usually made is an AIG point in regard to insurance, but I think it is always critical to point out that it was the financial products unit at AIG that created a lot of the issues, as opposed to the entities that we are talking about under this bill.

My time has expired.

The Chair now recognizes the Ranking Member, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Let me get right to one of the significant points that this hearing must address, I think. And because those who are opposed to this legislation are saying that this is a solution in search of a problem, a hammer in search of a nail, false teeth in search of food.

What I need to find out from you is whether you agree with that. Do any of you agree with any of the three examples, except the teeth?

Mr. BOCK. I would probably cast it a different way as 5059 is something we have been waiting for. We applied for deregistration in 2012 but stopped our deregistration process awaiting for legislative relief. So in terms of a hammer looking for a nail, I believe it is the appropriate tool that we need now to right-size regulation and remove the duplication.

Mr. CLEAVER. Mr. Schwarcz?

Mr. SCHWARCZ. Thank you. I want to address that issue, but if I may, I just need to turn back some—it is really one of my more important points and it goes to questions that Mr. Duffy was raising. So actually I understand that you characterize the intent of the bill, but I actually don't think you accurately characterized the effect of the bill.

So I just want to clarify how it is drafted so that you can re-draft it to reflect that intent because the way an insurance savings and loans holding company is defined on page 2 of the bill, is any one of three circumstances can be met in order for you to qualify as an insurance savings and loans holding company.

And you quoted from portion two of that definition, which contains a quantitative threshold for your assets. So in order to fall under subpoint 2 you would have to have 75 percent of your assets in an insurance holding company.

Subpoint 1 though, defines any entity that has a top tier savings and loans holding company that is an insurance underwriting company as an insurance savings and loans holding company irrespective what percentage of its assets are in insurance.

The effect of that is, and I know this is not your intent, JPMorgan tomorrow, if you pass this bill, could have its top tier holding company start issuing insurance, fall within an insurance savings and loans holding company, and then avoid Federal supervision.

So this is just an error in the bill that needs to be fixed in my view, and I really hope that even if you support the spirit of the bill that you fix this.

To get to—and I apologize but I just really needed to make that point—to get to the underlying question, I do believe that there are issues here that are important to address.

I believe that Federal supervision of insurance savings and loans holding companies should be tailored to the risks that are posed by those entities. And I believe that it shouldn't be duplicative with general oversight that insurance regulators are conducting.

But my understanding is that the Fed is very open to that. That the Fed currently doesn't engage in oversight of the State licensed insurance entities and that its oversight is focused at the group level to make sure that broader risk management concerns are being addressed. That is actually not the focus of State insurance regulation.

So my view is that right now is maybe there is a problem but this is not the solution, at least as it is currently drafted.

Mr. CLEAVER. Well, thank you. I am taking the devil's advocate position here. I am not—well, let me do it in a—I don't want to attack the devil, but I am looking for the validity of the legislation—how necessary it is.

And I said it in my opening statement that I am frustrated about duplicative or pedantic example, compliance cost, which I think my Republican friends and I, we agree on the need to reduce this.

But I need to understand as clearly as you can in 20-something seconds, how this is hurting your business?

Mr. MAHAFFEY. So if I could? I think the easiest proof is in the number of entities that are voluntarily divested or closed their banks in response to Federal Reserve supervision. Most of the entities we are talking about being affected by this bill had thrift operations before the financial crisis. They did not enter them post-financial crisis. But a number of entities have voluntarily decided to exit these businesses because, in their judgment, the costs simply outweighed the benefits.

Nationwide continues to believe that this provides a valuable product and service offering to our members, but the costs are significant. And despite the best intentions of the Federal examiners that are on the ground, there is unavoidable duplication.

Our holding company, our top tier company is a licensed insurance entity and so there is unavoidable redundancy in terms of what gets examined, the standards that are applied to those exams. There are over 200 SR (supervision and regulation) letters that are applied to us, most of which have equivalent standards that are different in the State insurance world.

So it is a reallocation of significant amounts of resources away from those exams to the Federal Reserve Exams. There is a heavy dose of education because by and large while the Fed has done a lot to come up to speed and staff up, it has required an inordinate amount of investment from the companies that are supervised to continue to work with them on the differences between insurance.

And again, I do not fault the Federal examiners.

Mr. CLEAVER. Time is up.

Chairman DUFFY. The gentleman's time has expired. That was a very long 20 seconds, but we appreciate the answer.

The Chair now recognizes the Vice Chairman of the subcommittee, Mr. Ross, the gentleman from Florida, for 5 minutes.

Mr. ROSS. Thank you, Chairman.

And then Mr. Bock, you have commented in your testimony on the cost and inefficiency of the Federal Reserve supervision and in fact, to follow up on Mr. Cleaver's, the Ranking Member's questioning, can you cite some examples of regulatory duplication as a result of current law?

Mr. BOCK. So regulatory duplication, the amount of reporting to the Federal Reserve is breathtaking. And they took a number of reports. So we actually provide to our own regulator, to the insurance regulators, like our own risk self-assessment every—

Mr. ROSS. And then you turn around and report it to the OCC—

Mr. BOCK. Absolutely.

Mr. ROSS. —and the Federal Reserve. Right?

Mr. BOCK. Absolutely. So the financial reports, et cetera, everything—

Mr. ROSS. And that inures to your bottom line no doubt.

Mr. BOCK. Absolutely. Absolutely. So we spent an additional, let us say, 25 percent of our time responding to the same issues that we always respond to our—

Mr. ROSS. And this current law is predominantly why Country Trust Bank is no longer in existence, correct?

Mr. BOCK. Well, we are in existence still with trust-only powers, so—

Mr. ROSS. OK.

Mr. BOCK. —so we deregistered for trust-only powers specifically to keep serving our customers but also to reduce the costs which had no benefit of Federal oversight.

Mr. ROSS. Mr. Schwarcz, I appreciate you raising concerns related to regulatory arbitrage, and I appreciate you being here and I can assure that I think that we would all agree that the intent here is not to provide a creative way for financial services conglomerates to avoid Federal oversight.

In fact, I believe the bill provides certain safeguards against this possibility by using a number of mechanisms, of which you alluded to. It defines an insurance savings and loan holding company as a savings and loan holding company that holds 75 percent or more of its total assets in an insurance underwriting company or companies, and it requires 75 percent threshold to be met in the most recent four consecutive quarters.

And it has to also have been a savings and loan holding company to have been registered before July 21, 2010. Now, these are some pretty significant safeguards. Are you suggesting that these aren't?

Mr. SCHWARCZ. Yes. No, I am suggesting they are and you are not—and I am suggesting you are actually not reading the bill correctly. If you look at page 2—

Mr. ROSS. All right. Yes.

Mr. SCHWARCZ. —line 23, it is an "or."

Mr. ROSS. So you suggest we put an "and"?

Mr. SCHWARCZ. Wait, so just let—well, if you put an "and" that would definitely—

Mr. ROSS. That would resolve it?

Mr. SCHWARCZ. That would resolve it but I think it would create other problems because actually several of these companies would no longer be an insurance savings and loans holding company.

Mr. ROSS. Well, but really what other problems would it create? It is not a less regulatory scheme as you say.

Mr. SCHWARCZ. Oh, no, it absolute is.

Mr. ROSS. On whose part?

Mr. SCHWARCZ. Well, I don't understand. If you are saying it is not—

Mr. ROSS. Well, I don't understand either because, you see, there are two regulators here.

Mr. SCHWARCZ. Right. Wait—

Mr. ROSS. Well, there are three in the Fed and there is one in the State.

Mr. SCHWARCZ. Yes. No, but let me try to answer, just—

Mr. ROSS. Oh, please do.

Mr. SCHWARCZ. Yes, OK, great. Thanks. So just let me be very clear. The definition of an insurance savings and loan holding company under the bill allows you to qualify if you meet any one of three criteria—

Mr. ROSS. Which are fairly stringent.

Mr. SCHWARCZ. No.

Mr. ROSS. Which will also prevent—

Mr. SCHWARCZ. No. The—

Mr. ROSS. Yes, they are.

Mr. SCHWARCZ. The criteria—

Mr. ROSS. Are we going to go back in time to July 21st period?

Mr. SCHWARCZ. The criteria that you own that your top tier savings and loans holding company is an insurance underwriting company can be satisfied if you take your top tier company and you get licensed in one State to sell any insurance you qualify.

Mr. ROSS. And that causes less stringent regulation?

Mr. SCHWARCZ. Of course. If you—

Mr. ROSS. To whom? What about the State regulator? Are you demeaning the State regulator by saying they don't require stringent regulation?

Mr. SCHWARCZ. Let me answer—

Mr. ROSS. I don't think you do. I think what we are doing is we are allowing the consumers to have the benefit of what has been probably the most efficient, effective and cost effective regulatory environment out there, and that is the State.

Mr. SCHWARCZ. I think it is interesting—

Mr. ROSS. Your testimony is incorrect. It doesn't require this law to come into effect to allow for less stringent regulation, just the opposite.

Mr. SCHWARCZ. I think it is really funny that you are saying that it is not stringent regulation but there are all—

Mr. ROSS. Well, you said it wasn't stringent regulation. You said this bill will lead to less stringent regulation and I—

Mr. SCHWARCZ. Of course it will.

Mr. ROSS. —take you to task to that.

Mr. SCHWARCZ. Because the—

Mr. ROSS. In the academic world yes, but maybe not in the real world.

Mr. SCHWARCZ. The Fed is not regulating you at the holding company level unless certain—

Mr. ROSS. But you are going to regulate—

Mr. SCHWARCZ. —criteria are met.

Mr. ROSS. —them at a State level.

Mr. SCHWARCZ. Yes, that is less stringent regulation.

Mr. ROSS. Correct. And that is not stringent. State level is less stringent?

Mr. SCHWARCZ. OK.

Mr. ROSS. The best consumer protections we have out there in any type of regulatory environment in this world and you are saying it is less stringent? The most significant, that is closer to the consumer, you are saying is less stringent?

Mr. SCHWARCZ. Can I answer or are you just going to talk to me?

Mr. ROSS. —you are saying less stringent?

Mr. SCHWARCZ. Well, I will answer if you want.

Mr. ROSS. I think you already have answered.

Mr. SCHWARCZ. Well, I don't—

Mr. ROSS. Go ahead.

Mr. SCHWARCZ. OK, sure. It is less stringent yes. That is precisely why there is less cost if you, in fact, avoid the regulation.

Mr. ROSS. And less cost is bad?

Mr. SCHWARCZ. No, it is good, but it is also—

Mr. ROSS. Thank you.

Mr. SCHWARCZ. —relates to there being less regulation. I don't understand how you can simultaneously say—

Mr. ROSS. It is because of—

Mr. SCHWARCZ. —we are reducing the regulatory burden but we are not reducing regulation. The two go hand-in-hand.

Mr. ROSS. Well, you already have duplicative regulatory burden that has been in existence since Dodd-Frank. We are trying to remedy that and that is what this does and still allows for stringent regulation on behalf of the States.

Mr. SCHWARCZ. Whether or not it is appropriate we can debate about that. It does reduce the amount of regulation. OK?

Mr. ROSS. It is duplicative regulation.

Mr. SCHWARCZ. It may reduce duplicative—

Mr. ROSS. And that is a bad thing? That in and of itself is indicative of why we have a difference here.

Mr. SCHWARCZ. If you create a—it is a bad—

Mr. ROSS. I think we need less regulation when it burdens the consumers.

Mr. SCHWARCZ. OK.

Mr. ROSS. I yield back.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the co-author of this bill, the gentlelady from Ohio, Mrs. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you so much, Mr. Chairman and Ranking Member. I have a series of questions so I am going to ask you for shorter answers.

But first, Mr. Chairman and Ranking Member, I would like to enter this statement for the record. It is a letter from the American Council of Life Insurers supporting this bill.

Chairman DUFFY. Without objection.

Mrs. BEATTY. Again, let me thank all of the witnesses here and say how much respect I have for all three of you. And at any time in my career that I have read something from all three of you, here is a good answer: I have agreed with all of you on some things.

So we are going to take it down a little notch here and first let me say to you, Professor Schwarcz, that I appreciate your comments. And you would be happy to know that we are already in some discussions about making some changes which are no doubt important.

But after hearing Mr. Bock's story about COUNTRY Financial, Professor Schwarcz, do you believe that spending 25 percent of a company's compliance cost on a subsidiary that accounts for only 0.2 percent of a company's total assets is excessive and burdensome? And a quick answer.

Mr. SCHWARCZ. Yes, it may well be. I do think that there is a very important goal here of reducing regulatory costs. I just think we need to do so appropriately.

Mrs. BEATTY. OK. So let me say to all three of you that we have three members from the great State of Ohio here so to my good friends from Nationwide, I know I speak on behalf of my other two colleagues and you may later tell my two Republicans that I spoke for them today, in thanking you.

But also beyond this I want to thank you for running an outstanding business and that you have been a true partner to the community to help Columbus and central Ohio to keep us moving forward.

Mr. Mahaffey, this question is for you. Nationwide is subject to group-wide supervision by the Ohio Department of Insurance. Is that correct?

Mr. MAHAFFEY. That is correct.

Mrs. BEATTY. In addition to being regulated by the State of Ohio, are you not also subject to financial condition supervision and regulation in Arizona, California, Iowa, Michigan, New Jersey, New York, Texas, as well as subject to insurance regulations in all 50 States and the District of Columbia?

Mr. MAHAFFEY. Yes.

Mrs. BEATTY. And on the Federal level are you regulated by FINRA, the OCC, SEC, Department of Labor, IRS, and subject to group-wide supervision by the Federal Reserve?

Mr. MAHAFFEY. Yes, that is also correct.

Mrs. BEATTY. Seems like a lot of regulations to me. Are you aware of any other class of financial institutions that have dual holding company supervision by the Federal Reserve and another prudential regulator?

Mr. MAHAFFEY. No, not in the U.S.

Mrs. BEATTY. Are insurance savings and loan holding companies regulated on a group-wide basis by two regulators because they are the biggest and most complex insurance company if they were to fail that would bring down the U.S. economy?

Mr. MAHAFFEY. No.

Mrs. BEATTY. And who has had more experience and more expertise in regulating insurance companies, such as Nationwide, the Ohio Department of Insurance or the Federal Reserve?

Mr. MAHAFFEY. Cleary the State departments.

Mrs. BEATTY. If this bill were to become law would you still be regulated by the Ohio Department of Insurance and all other States you do business in?

Mr. MAHAFFEY. Yes.

Mrs. BEATTY. Your depository institution will still be regulated by OCC. Is that correct?

Mr. MAHAFFEY. That is correct.

Mrs. BEATTY. And you will still have to comply with the Federal Reserve's insurance capital requirement, submit various reports to them and be subject to direct supervision if the Federal Reserve believed that your company was in material distress. Is that correct?

Mr. MAHAFFEY. That is correct. And I would include in those capital standards prospective stress testing as another requirement.

Mrs. BEATTY. OK. Can you explain the benefits Nationwide's depository institution provides to your business, your customers, and why you have made a decision to not get rid of it?

Mr. MAHAFFEY. Sure, and I will—being as brief as possible, one benefit we have as a mutual insurance organization is the benefit of diversification of our risk portfolio. That is the benefit of anybody buying insurance is diversified risk.

The bank gives us another business with uncorrelated risks to the rest of our business. More directly to our members, to those people we exist to serve, it provides additional products and services that we can uniquely tailor to their needs that work in concert with the other products and services we offer.

The examples I gave in my testimony of prepaid claims cards and emergency debit cards for folks in the wake of natural catastrophes are perfect examples of that.

Mrs. BEATTY. And last, do you not believe that the State-based insurance system that has governed this country's insurance system for almost 150 years is effective and time-tested?

Mr. MAHAFFEY. Yes.

Mrs. BEATTY. Thank you, Mr. Chairman. And I yield back.

Chairman DUFFY. The gentlelady yields back.

The Chair now recognizes another author of this bill, the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Chairman, and again, I want to thank my colleague, Mrs. Beatty, for her work on this legislation. She introduced a letter from the ACLI. I would like to offer for the record letters of support from the Property Casualty Insurers Association of America, as well as the National Association of Mutual Insurance Companies for the record.

Mr. Chairman?

Chairman DUFFY. You had—

Mr. ROTHFUS. Yes, I wanted to offer for the record a couple of letters of support, one from the Property Casualty Insurers Association of America and the National Association of Mutual Insurance Companies.

Chairman DUFFY. Well, without objection.

Mr. ROTHFUS. I want to talk a little bit about the Ranking Member raised this issue. Is this a solution in search of a problem?

So if I can go to you, Mr. Mahaffey? And again, we have heard from Mr. Bock about their compliance costs. Can you elaborate on how Fed supervision has affected compliance costs in Nationwide's business of operations and compliance costs?

Mr. MAHAFFEY. Yes

Mr. ROTHFUS. OK. Can you quantify it at—

Mr. MAHAFFEY. We have similar experiences. It is a reallocation of finite resources. And to be clear, we have added resources to comply with those Fed standards and regulations and examinations.

I think the estimate of 25 percent to 30 percent of, for example, my team's time in enterprise risk or in the compliance function as an example, being reallocated to these is a reasonable estimate. But I would also argue that those costs that are very difficult to quantify go well beyond just those dedicated teams that have direct responsibility for the relationship in conducting the exams.

It is a prominent focus all the way from the board through senior management to direct frontline associates given the extensive nature of the supervision and the ongoing presence of examinations. So the costs are material and there are specific examples where we have had to incur very specific costs to stand up programs that comply with Federal Reserve expectations.

Mr. ROTHFUS. Can you tell us what aspects of Fed supervision are inappropriate for an insurance company?

Mr. MAHAFFEY. I would start by highlighting the differences in the nature of their supervisory frameworks that they bring to bear, as we have all said in our testimony they come with a banking-developed toolkit. So the basis from which they engage and—

Mr. ROTHFUS. Notwithstanding that they were supposed to be getting some expertise in insurance. You still find this to be a problem?

Mr. MAHAFFEY. And I would say yes, we do still find it to be a problem and I will still give them credit for working with us, for example, on the Capital Standards Clarification Act and the capital standards in the wake of that. We found them to be very willing partners, but you are talking about an immense body of knowledge that has been developed over decades exclusively with the banking arena.

And porting that over into an insurance world has inherent inefficiencies. And when you apply that at the group level, redundancy and duplication is unavoidable.

Mr. ROTHFUS. Mr. Bock, we have heard from Mr. Mahaffey about how Nationwide used it as S&L. Can you elaborate on what role the former S&L played for COUNTRY?

Mr. BOCK. It is still our trust bank. It houses our wealth management business, so it still exists. It was a grandfathered unitary savings and loan holding company that was under OTS from Gramm-Leach-Bliley.

But we wished to hold ourselves with that status through conversion into being regulated by the Federal Reserve, but found, as we have said, the costs were way too high for the benefit that it was providing to our policyholders.

Mr. ROTHFUS. What kind of consumer impacts would you see as a result of this action for your customers?

Mr. BOCK. This action that we took?

Mr. ROTHFUS. Yes.

Mr. BOCK. It obviously reduced our costs. We now spend our time focused on those risks and those things that are most beneficial to our policyholders. And it allows us to let our regulators play the role that they should play, the State regulators regulating us, OCC, et cetera.

Mr. ROTHFUS. Mr. Mahaffey, is Fed supervision as it is currently conducted necessary to protect against systemic risk? Or is it possible to achieve the same goal more efficiently with respect to Nationwide?

Mr. MAHAFFEY. We definitely think it is possible to achieve the same goal more efficiently. And you mentioned systemic risk. I will note that the Fed has said publicly on many occasions that these ISLHCs that we are talking about do not pose systemic risks.

And this bill does not touch the authority of the FSOC to designate anybody who would pose a future systemic risk to come back into Federal Reserve supervision.

As it is currently conducted, there are definitely opportunities. We think this bill addresses that opportunity.

Mr. ROTHFUS. In working on this legislation, I wanted to ensure that this bill solves the problem we have identified while guaranteeing that vital information gets to the appropriate regulator. Again, this is about right regulating, not deregulating.

Mr. Mahaffey, can you please talk a bit about how this bill would change which reports you provide to which regulators and why that deconfliction is important?

Mr. MAHAFFEY. Yes. So the way I would describe this is this would respect the primacy of the department of insurance in the State of Ohio as the primary day-to-day supervisor and examiner of Nationwide.

The Federal Reserve would have access through the State department of insurance for all of the information that they would garner from Nationwide in the same way that all of the other States that play a supervisory role for Nationwide patriate and cooperate with Ohio for that information.

It would also provide them with direct access to a lot of individual information on financial reporting, holding company structure, legal entity structure, business structure, and all of the necessary requirements for their capital standards.

So they would have direct access for the important information necessary to monitor that system. We think that construct provides a ton of efficiency for Nationwide by removing that day-to-day duplicative examination burden that really requires that inordinate amount of time that I described and Mr. Bock described.

Mr. ROTHFUS. Thank you. My time has expired.

Chairman DUFFY. The gentleman's has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Bock, there are currently 12 insurance savings and loans holding companies that fall under Federal supervision due to the fact that they own a depository institution. Can you give us a description of these companies? What business are they in? What type of products do they offer? What is the risk profile?

Mr. BOCK. I can—thank you. I can give you just a quick thought as they range from companies that are very multidimensional like Nationwide, that serve a broad range of customers, all the way down to companies such as Westfield, which serves a regional market, the same thing, its customers.

And so the banks are therefore focusing on customer products and diversification, as Mr. Mahaffey said. So in terms of their risk, it is absolutely limited because of the current supervisory structures that they had prior to Dodd-Frank.

Ms. VELAZQUEZ. OK. So what does owning a thrift allow these companies to do that they otherwise wouldn't be able?

Mr. BOCK. In today's world, obviously financial security is important for every home, every customer, and it allows insurance companies to focus on the needs of protection as well as preservation of assets. And so it serves a broader range of protection, but also protection for great retirements, et cetera. So that is—

Ms. VELAZQUEZ. Thank you.

Mr. BOCK. —that is my personal view.

Ms. VELAZQUEZ. Thank you.

Mr. Mahaffey, same question to you. What does owning a thrift allow Nationwide to do that otherwise would not be able to?

Mr. MAHAFFEY. So the purpose of our thrift institution is not to create a large independent bank that serves non-member customers for Nationwide. And it is quite the opposite.

Our owning of a thrift is designed to create products and services that augment our existing insurance and financial services products in ways that we think create convenience and other sources of value for our members, like those post-catastrophe claims cards and debit cards, things that would be very difficult to execute if we were doing with a third-party partnership because they would have a different interest in how—

Ms. VELAZQUEZ. Thank you.

Mr. MAHAFFEY. —they serve our members.

Ms. VELAZQUEZ. Professor, would you care to comment on it?

Mr. SCHWARCZ. Yes, so I think that it varies, and I think that in certain contexts, like Nationwide the bank may be very small. For other insurance savings and loans holding companies the bank actually can be a substantial portion of the company.

So just for instance, USAA, I think their bank has $80 billion in assets. TIAA just acquired EverBank, which I think had many, many billions of dollars in assets and used to operate as a free-standing banks.

The other point I would just make is, banks allow you to serve your customers in unique ways. They also do create unique risks and that is because they are Federally insured. They are unique in that respect. And that is why banking regulation is different than other types of regulation and it is also why it has to occur both at the level of the individual bank and at the holding company level.

If you only have bank regulation at the individual level of the bank then there is a substantial risk that that bank can actually be either exploited by its non-bank affiliates or can actually be destabilized by those entities.

Ms. VELAZQUEZ. Thank you.

Mr. Mahaffey, I am very concerned about bifurcated regulation, and I am concerned about the regulatory regime this bill creates. I was here in 2008 and witnessed the near collapse of AIG and how it and other firms like it nearly destroyed the financial system and world economy.

Please tell me how H.R. 5059 can both relieve the duplicative regulation that you spoke to and yet guarantee the public that we are not ushering in another AIG.

Mr. MAHAFFEY. Thank you for the question. I think it is important to note that this does not remove the role of Federal supervision from the group level. It simply delineates it from the role of the State and in my opinion sequences it so that it has a complementary role not a redundant role.

So what we are seeking to do, and I think Chairman Duffy described it very well, as it related to our bank we have an OCC-dedicated regulator that would be full-time. We have a group consolidated supervisor at the State level and the Fed would still remain responsible for the holding company with review authority for all of the information and ensuring the completeness of coverage of regulators within the holdco with the ability to step back in if we fail certain tests, like the capital standards.

Ms. VELAZQUEZ. Thank you.

Professor, your take on this question?

Mr. SCHWARCZ. So first, I agree that a very important element of this bill is that it doesn't restrict FSOC's ability to designate firms like AIG as systemic, so I do think that that is an important point and one reason why it is not as dangerous a bill as it very much otherwise could be.

So I don't think we are talking about systemic risk concerns. I think what we are talking about instead is the concern that American taxpayers will end up having to incur the costs associated with bailing out a bank that failed because of its non-bank affiliates.

Ms. VELAZQUEZ. Thank you.

Mr. SCHWARCZ. Yes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. I yield back.

Chairman DUFFY. The gentlelady's time has expired.

The Chair now recognizes the gentleman from Missouri, the Chair of the Subcommittee on Financial Institutions, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

And welcome to our guests. And I want to thank Mr. Rothfus for his common sense legislation here that I think Mr. Mahaffey, you just really did a good job of summarizing what we are trying to do here is not to deregulate but to find a way to not have this burden—this extra layer of regulation there that could cause us costs and confusion, so appreciate that.

Also I appreciate Professor Schwarcz's comment a little bit ago with regards to tailoring regulations to risk. I think that is extremely important.

I think we are trying to do that as a committee on a lot of levels to try and find ways to make sure that the regulations are not there to be more punitive than necessary and continue to allow the freedom of businesses to do their job but at the same time making sure there is a box within which they operate. And you have to tailor the regulations to make sure that you protect that—box. And I appreciate that comment from the professor.

Mr. Mahaffey, you have been very articulate with regards to how your company is working through this and I just have one more question for you with regards to the relationship with the Federal Reserve and your ability to do your job.

If the Federal Reserve is overly cumbersome how does it really affect your business to assess and do your job with regards to insurance risk?

Mr. MAHAFFEY. To the extent we are allocating scarce time and energy amongst my staff or other risk-related staff within the organization, if we are doing so in a duplicative manner that probably actually results in less time for other material risks that could otherwise use that time.

And I would point to the fact that because there are inherent differences in the risk profile of insurance entities versus banking entities, that by and large has meant we are pulling time away from what I would consider to be potentially more material risks on the insurance side on natural catastrophes, mortality, morbidity. These are not risks that exist in a banking construct.

So all of our time and energy is spent competing for where we allocate that time to manage these risks. This would reduce duplication and allow us, I think, to be more efficient in the allocation of risk management time, which, by the way, coincides with the ability to protect policyholders and depositors.

Mr. LUETKEMEYER. I think, Mr. Bock, a while ago you mentioned something about the regulators using bank standards to regulate insurance companies? I believe you made a comment to that effect? I am sure you didn't mean that, but I am curious as to what was going on with that comment, because it raised some—

Mr. BOCK. Our experience. Yes, thank you. Thank you. Our experience was that the standards they use, the SR that Mr. Mahaffey referred to, were the same ones that came from the banking experiences. So yes, we were hoping for tailored or appropriate—

Mr. LUETKEMEYER. So they really were using and really inaccurate standards in your judgment?

Because you have two separate business models here, the banks and the insurance companies have two completely different business models and really you need to have two separate tailored rules for those folks. And yet the regulators were using more of a bank standard to analyze the insurance part of this? Is that what you are saying?

Mr. BOCK. I would say so not necessarily bank capital standard, but they were using their SRs, their bank checklists, to go through things like cyber-security risk, enterprise risk, et cetera. So they were not tailored to us as an insurer to our size as a—

Mr. LUETKEMEYER. OK. You are using the word were. Have they changed this now? Are they doing a better job?

Mr. BOCK. We left Federal supervision in—

Mr. LUETKEMEYER. OK.

Mr. BOCK. —in 2017.

Mr. LUETKEMEYER. OK. You had a buzzword there that is important to me. We are going to have a data security, cyber-security hearing this afternoon, and I have a bill that we are working on to try and address some issues there with data security.

And so one of the questions that is going to come up this afternoon is the duplicative nature of all of the different rules and regulations with regards to data security and cyber-security notification across the country.

You have 50 States and you have anywhere from 40 to 50 different standards on things. Do you see some duplicative problems here with the way cyber is looked at with the Fed and State examiners?

Mr. BOCK. There is some duplication. I would say that the State insurance departments, the NAIC are looking to coordinate to ensure we have a common and a very thoughtful—

Mr. LUETKEMEYER. Do they work collaboratively on this?

Mr. BOCK. Excuse me?

Mr. LUETKEMEYER. Do they work together on this to make sure there is—

Mr. BOCK. I would say—

Mr. LUETKEMEYER. —no overlapping problem?

Mr. BOCK. I would say that it is emerging right now because the New York Department of Financial Services has been very vocal about how to improve cyber-security, how to improve cyber-security reporting.

Mr. LUETKEMEYER. I don't have much time left, so I will be very brief here.

I think Mr. Mahaffey you made a great comment a minute ago with regards to the OCC is one regulator, the State's one regulator and the Fed regulates your holding company. I am not sure if some people understand the relationship between the bank that you have, the insurance company that you have and then the holding company.

Could you just use a few minutes here, with the indulgence of the Chairman, to give that relationship so people understand why that is there and what the purpose of it is and how it is regulated?

Mr. MAHAFFEY. Sure. So in our case our top tier holding company is a licensed insurance operating company, which means everything underneath that holding company is subject to State supervision. One of the entities within that then—

Mr. LUETKEMEYER. So the holding company actually owns both entities and then the Fed is examining that entity. Is that correct?

Mr. MAHAFFEY. The State and the Fed examine the holding company, which includes all of—

Mr. LUETKEMEYER. OK.

Mr. MAHAFFEY. —Nationwide's subsidiary entities and that holding company is a licensed insurance entity as well.

Mr. LUETKEMEYER. OK, thank you very much.

Appreciate your indulgence, Mr. Chairman.

Chairman DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Mr. Bock, in your oral testimony you spoke positively about State regulation. Perhaps you could drill down into the specifics and help the committee better understand what processes State regulators use to ensure that consumers are protected?

Mr. BOCK. Thank you. The State regulators maintain a continuous discussion with us every day. They have the gold standard in financial reporting. The development over the last 5 years of onerous self-assessment, enterprise risk management tools, et cetera, reports to them, really safeguard the customer.

And so what I would say is their regulation and oversight is continuous. They know us. They've known us for the last 92 years.

Mr. SHERMAN. Thank you.

Professor Schwarcz, we have to protect the depository institution in large part because it is federally insured. The management and directors of such an institution could make a number of mistakes in making bad loans. They could pay dividends and stock buybacks to deplete their capital.

So if we are looking at the entity itself, the banking entity, why should we be more concerned if its ownership is affiliated with an insurance company than we should be about the entity itself if it isn't affiliated with an insurance company, but its board of directors may just not want to keep too much capital around?

Mr. SCHWARCZ. It has actually been a principle of banking regulation for 70 years I would say that we have to regulate both the entity and the holding companies. The Bank Holding Company Act established that in the 1950's.

And it has been the case for savings and loans holding companies before Dodd-Frank. I think that is a really important point. Before Dodd-Frank savings and loans holding companies are regulated at the holding company level.

The reason is because failures of the non-bank affiliates can end up affecting the bank. It can end up being the case you get preferential loans to the non-bank holding company. It can end up being the case that there is no capital to be made.

In other words, it can end up being a source of weakness, and we saw this with AIG. AIG's insurance companies were endangered by the fact that we had other entities that were not insurance entities that were in jeopardy. The same thing could happen with banks.

Mr. SHERMAN. Well, the big problem there is that, and we have talked about this, is that we allowed AIG's unregulated entity to sell credit default swaps, which, at least I believed, to be portfolio insurance.

Mr. SCHWARCZ. Right. I would just not forget about the securities lending operations as well, which were under the supervision of the insurance regulators. So there were issues on multiple levels with AIG.

Mr. SHERMAN. Well, OK. To what extent can the—Professor Schwarcz, can the Federal Reserve further tailor its supervisions of insurance savings and loan holding companies in a responsible manner? What can we do? I know you don't want to go as far as the legislation before us. What can we do to limit the—

Mr. SCHWARCZ. Well, no—

Mr. SHERMAN. —regulatory burden?

Mr. SCHWARCZ. —I think that is a really important question and I guess that is where I would focus if I were you, and that is where I would focus the injury. I would ask that question, how do we change it? I think the answer is you have less stringent supervision depending upon the size of your bank and depending upon the complexity of your organization.

My concern is that this bill doesn't tailor because it actually cuts off the Fed's authority to regulate at the holding company level unless one of several clear triggers are hit. There is a capital deficiency or there is a determination that it is in material financial distress.

And so my concern is that actually rather than tailoring you are actually going in the opposite direction of cutting off the Fed's ability to tailor. I have no qualms with the idea that perhaps the Fed—perhaps, I don't know—the Fed may need to better tailor its supervision—

Mr. SHERMAN. I want to hear from Mr. Bock on that same issue.

Mr. BOCK. I think the bill does a very thoughtful way of still retaining the Federal Reserve's ability to step in to take action so it doesn't diminish the Fed's ability in any sense of at least the language in the bill.

Mr. SHERMAN. I will yield back.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from Illinois, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you all for being here. We appreciate your testimony and your work.

I am going to address the first questions to Colonel Bock if I could? Again, thank you for your service. Also I know out of the 5,000 plus employees that you have, 3,600, I think, are in Illinois. So we are grateful for that, the big impact on our State and tons of customers as well. So grateful for that.

I did want to just—and we have talked about this but I wanted to go into a little bit more specifics. In your testimony you noted that country Financial maintained a savings and loan holding company up until recently and then you made the decision to de-register it because the regulatory burden greatly outweighed the value to the company and your policyholders.

I wonder if you can think of any other example in insurance or banking regulation where something that is 0.2 percent of your overall assets accounts for 25 percent of the hold—the company's total compliance staff resources? It seems obvious to me that Congress needs to revisit this duplicative regulation, but wondered if you could talk a little bit more about that?

Mr. BOCK. Yes, thank you. Obviously we kept registered, awaiting for regulatory relief, and we have been told that your supervision by the Federal Reserve is just your price of admission. But quite frankly, we were already at the movie. We were already at the movie and the admission cost went up.

We sat and reviewed, just like Mr. Mahaffey did, to where we were spending an inordinate amount of time on something that was adding no value to our policyholders. And so really for the benefit of our policyholders it was a decision we had to make.

Mr. HULTGREN. I wonder if you could talk a little bit about the strength of State regulation? Could you be more specific about how State regulators supervise a company like yours and why is this regulation as good or better than Federal regulation could be?

Mr. BOCK. Well, I think this one gives a clear and thoughtful way of a division of responsibility, the division of labor. Our State regulators obviously get our financial reports consistently. They have the ability and the number of tools to be able to intervene and to question and to ask.

So we also, at this point in time, are going through our 5-year financial exam, and that is an exam that lasts for at least a year or a year and a half. So there is nothing that our State regulators don't know about how we conduct business and they have market conduct evaluations, et cetera. So they have a huge toolbox with which to regulate us and which to interact with us.

Mr. HULTGREN. I know you have talked about this briefly, but wonder if you can go into just a little bit more detail of explaining why a change in law is necessary in order to have a State-based regulation as the primary approach?

Mr. BOCK. Well, obviously, we are strong supporters of McCarran-Ferguson because the State-based approach has consistently and continuously worked. When the Federal Reserve came to us, when we talk about regulation, it was duplication to a massive extent and with no benefits.

So if I take a look at this legislation it actually does thoughtfully give a division of labor. It also has some safeguards, but it certainly doesn't allow someone—now, I can't imagine someone like JPMorgan Chase trying to become an insurance company and having the Federal Reserve Board allow that or having a bank buy an insurance company and the capital requirements or have an insurance company buy a bank and the capital requirements that it is required.

So some of the things that sound like gaps are not gaps. They have absolutely been filled by our current regulatory scheme.

Mr. HULTGREN. That is helpful, thank you.

Mr. Mahaffey, I have just a minute and a half or so left. The number of companies that would be considered insurance savings and loan holding companies under this bill has decreased significantly since the enactment of Dodd-Frank as firms have eliminated their thrift subsidiaries.

Why would an insurance company maintain a thrift subsidiary and how has maintaining a thrift benefited Nationwide and its policyholders?

Mr. MAHAFFEY. Well, again, we, like Mr. Bock, have been hopeful for regulatory relief and fixes, and we would again applaud the Fed for their ability within the confines of the current construct, the current regulatory regime, to be flexible where they can. But we do think that this bill goes further and actually changes the very construct in which both the State and the Fed need to operate to align them better.

Without this it does raise questions amongst most of those institutions about whether the cost justifies the benefits to the holding company. In Nationwide's case we have continued to own and operate our bank precisely because we continue to see the potential for massive benefit to our policyholders to continue to offer these products and services.

Mr. HULTGREN. Thanks. In just the last few seconds, I wonder if you could talk a little bit about how this bill, H.R. 5059, would reduce its compliance cost for Nationwide?

Mr. MAHAFFEY. It would dramatically reduce compliance costs and I would say allow us to redirect our resources to what we would consider to be the more material risk profile of an insurance organization because it would sequence and it wouldn't eliminate the role of the Fed, but it would keep them in a monitoring mode to ensure sufficient coverage by the State regulators and other regulators within the holding company and only to step in and then subject us to examinations in the bevy of SR letters we have referred to in the event we fail capital standards, stress test or there is an entity within our holdco that is not functionally supervised. So it would be exception-based.

Mr. HULTGREN. Thank you very much. My time is up.

I yield back.

Chairman DUFFY. The gentleman yields back.

The Chair now recognizes the gentleman from New Jersey, Mr. MacArthur for 5 minutes.

Mr. MACARTHUR. Well, thank you. Good morning and thanks for being here.

Mr. Mahaffey and Mr. Bock, if your thrift had gotten into trouble and you needed to move assets to help it, would you be able to do that from your insurance company holdings without approval from State regulators?

Mr. BOCK. No.

Mr. MAHAFFEY. No, and I would simply add the caveat, however, that as a mutual insurance organization we target having sufficient levels of capital, very conservative levels of capital by most measures because all of our entities within our organization share the same brand.

And so it would be in our consolidated interest to make sure that all of our entities, including the holding company, have sufficient capital to weather all of those sources of risk within the holding company.

Mr. MACARTHUR. So it would be fair to say then that there would be no material risk to your policyholders because of problems at the thrift?

Mr. MAHAFFEY. Speaking for Nationwide Bank, it has roughly $7 billion in assets and is part of a holding company with $230 billion in assets, so I would suggest to you that the risk posed within our depository relative to our overall holding companies is *de minimis*.

Mr. BOCK. I would say the same. Our life insurance company owns the bank. The life insurance company has $1.2 billion of surplus. Our bank assets are about $25 million and so in terms of a material risk to the life company, no. And I would also add that the State insurance regulators review carefully ownership of affiliates.

Mr. MACARTHUR. Sure. I will come back to the exceptions with Professor Schwarcz, because you have mentioned them, but it makes me feel like if I have this glass of water and I put a drop of lemonade in it I haven't turned it—or a drop of lemon juice I haven't turned it into lemonade. It is still a glass of water.

And an insurance company that has a thrift it doesn't turn it into a bank. It is still what it was. It just has a thrift.

Professor Schwarcz, you implied in your opening statement that a company, a bank, if it wanted to avoid Federal oversight could simply declare itself an insurance company and skirt the rules. Are you aware of any State that allows an insurance company to be formed without achieving certain capital requirements?

Mr. SCHWARCZ. No. Every State you have to be licensed and you have to meet certain capital requirements. But under the bill, if you could convince one State to license your top tier affiliate and you could put capital in there, then you would actually not be subject to routine Federal oversight. So that is the issue.

Mr. MACARTHUR. Well, you would not be subject to oversight in one construct but you still would be subject to bank oversight from the OCC and insurance oversight from insurance regulators.

Mr. SCHWARCZ. But you would be able to escape bank holding company regulation, which is essential for large banks.

Mr. MACARTHUR. Well, and you didn't say this, but I inferred it from your comments that you are concerned that insurance regulators might not have the capacity and the expertise to regulate a bank holding company, right, or a company engaged in banking? Is that fair?

Mr. SCHWARCZ. Well, that is fair and then also just an important related point, Federal funds are on the line with the bank because they are Federally insured. So if you have a Federally insured institution you want Federal regulation to match that source of liability.

Mr. MACARTHUR. Can you tell me what percentage of Federally insured bank assets have actually been put at risk in any given year?

Mr. SCHWARCZ. Well, that question needs to be unpacked. It depends a lot on what—

Mr. MACARTHUR. I get it. But it—

Mr. SCHWARCZ. —by.

Mr. MACARTHUR. —but you are wanting the tail to wag the dog, it seems to me.

Mr. SCHWARCZ. Well—

Mr. MACARTHUR. But let me just ask this. If insurance regulators are not really the best regulator for banks, what makes you think that the Fed is the bet regulator for an insurance company?

Mr. SCHWARCZ. Oh, no, I certainly don't. And to be clear, current regime doesn't envision, and my understanding is that the Fed doesn't actually go and supervise the insurance companies. That is not what the Fed is doing. What the Fed is doing is supervising the holding company and at a group level.

Mr. MACARTHUR. Well—

Mr. SCHWARCZ. So they are not actually—there is not—

Mr. MACARTHUR. Just one follow up on that, you had mentioned AIG as an example numerous times. If this bill had been law in 2007—well, that is not fair. If this had been law and SIFI designations were also in play, so that would be after 2007, would AIG be able to skirt or any company be able to skirt?

Mr. SCHWARCZ. Well, it depends a lot on whether or not they were appropriately designated as a SIFI, which, of course, is itself an authority that is not being exercised. But absolutely there would be a concern about that.

And I would just point out again because I do think it is really important. Even before 2008 savings and loans holding companies that were predominantly engaged in insurance had a Federal umbrella regulator. This isn't just going back to 2008. This is changing the regime that has been in place for decades and decades.

Mr. MACARTHUR. I have to yield back, but I would just end by saying there is still regulation of the bank operation here through the OCC. Your belt and suspenders approach comes at a cost, a cost to customers, a cost to shareholders and that is what we have to weigh. It comes at a real cost.

I yield back.

Chairman DUFFY. The gentleman yields back.

I want to thank our witnesses for their testimony today. I think it was insightful, thoughtful, and you have all given us some more information to think about, which is the purpose of an evidentiary hearing like this. So we appreciate your testimony and insight.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Without objection, this hearing is now adjourned.

[Whereupon, at 11:35 a.m., the subcommittee was adjourned.]

A P P E N D I X

March 7, 2018

Testimony of Kurt Bock

Chief Executive Officer of COUNTRY Financial

On Behalf of PCI

Before the United States House of Representatives Financial Services Committee

Subcommittee on Housing and Insurance

Hearing on H.R. 5059, the "State Insurance Regulation Preservation Act"

Mr. Chairman, Ranking Member, and members of the Subcommittee, my name is Kurt Bock, Chief Executive Officer of COUNTRY Financial. I appreciate the opportunity to testify today on behalf of the Property Casualty Insurers Association of America (PCI), which represents 1,000 insurers and reinsurers with combined annual premiums of $220 billion. PCI member insurers and reinsurers represent a vast diversity of size and business models and provide insurance coverage critical to families, communities and businesses throughout the U.S. and the world.

COUNTRY is a mid-sized financial company from America's heartland that has had an A+ rating for over 75 years. We were formed by a group of farmers in 1925 and now provide home, auto, business and life insurance, as well as retirement investments and education funding, to individuals, families, and Main Street businesses. COUNTRY Financial has always had an A.M. Best rating of A+ or superior. We are one of only ten life companies and sixty property casualty companies in the U.S. that has been rated A or better for over 75 years. COUNTRY Financial' s top priority is always our customers, and we assess any regulatory changes or proposals through the lens of our policyholders.

State-based insurance regulation of COUNTRY effectively oversees all aspects of our insurance operations. COUNTRY previously maintained a very small savings and loan association that accounted for only 0.2% of COUNTRY's total assets. Last year, COUNTRY deregistered our COUNTRY Trust Bank because regulation of our Savings and Loan Holding Company by the Federal Reserve Board expanded to include regulation of the entire COUNTRY insurance enterprise, consuming 25% of our holding company's total compliance staff resources. The Federal Reserve staff are exceptionally bright and professional. But neither they, nor COUNTRY, nor our economy have been well served by wasting extensive government and company staff attention to financial activities that are systemically insignificant and largely irrelevant to their core missions. This kind of inefficiency benefits no one--not our company, not our regulators and most importantly, not our customers. Even though COUNTRY is no longer subject to Federal Reserve Board oversight, we hope that sharing our experience will help Congress right-size federal involvement in insurance and make Federal Reserve Board oversight more proportional, tailored, and refocused on their core mission.

The Current U.S. State-Based Insurance Regulatory System

The U.S. has the largest and most diverse insurance market in the world, with a 150-year track record of comprehensive state solvency regulation protecting consumers. I am particularly proud of the role that our industry and COUNTRY Financial have played in helping to bring about safer homes, workplaces, and highways -- efforts that have saved countless lives and prevented the waste of huge amounts of resources. And I am equally proud that our financial investment in America's future through the municipal bonds that we buy helps build critical infrastructure that leads to a higher quality of life.

Last year, United States consumers suffered record losses from historic natural disasters – hurricanes, wildfires, earthquakes, and tornadoes. The insurance industry rose to the challenge, communicating closely with our policyholders, working with federal and state disaster crews and regulators, and speeding claims payments to families and businesses suffering losses. Despite these tremendous challenges, industry solvency and financial strength have remained at record highs. At the same time, overall customer satisfaction among homeowners with property insurance claims has reached a new all-time high as reported in a recent J.D. Power survey (Appendix 1). The U.S. insurance industry cares about serving its policyholders and giving people a helping hand up. It is already very extensively regulated by nearly 11,000 regulatory staff in state insurance departments, without need for additional layers of federal supervision (Appendices 2 and 3).

Private sector insurance availability and competition are better than ever for consumers (Appendix 4) and government residual markets have been steadily declining as the private sector has dramatically improved insurance availability to address consumer needs. Compared to federally regulated banks, state regulated property-casualty insurers fared relatively well during the last financial crisis (Appendix 5), with significantly fewer insurance insolvencies as compared to banks. The decline during the crisis in the stock valuations of publicly-held property-casualty insurers was not only far less than for banks but also less than the decline of the New York Stock Exchange composite index (Appendix 6). Property-casualty insurers also continue to be far less leveraged than banks, nor are property-casualty failures correlated with broader economic cycles. The local focus of our state-based insurance regulatory system supports responsive property-casualty insurance markets that address regional needs as well as the specific needs of local insurance customers. Simply put, insurance is different than banking, and bank regulation is not a good fit for insurance holding companies.

Dodd-Frank and the Federal Reserve Board

In Dodd-Frank, Congress repeatedly recognized the primacy of state regulation but also abolished the Office of Thrift Supervision (OTS) and, in the process, gave the Federal Reserve new authority over insurance holding companies with thrift subsidiaries.

Although Congress preserved the Home Owners Loan Act and a distinct holding company structure to govern savings and loan holding companies differentiating them from bank holding companies, the Federal Reserve has continuously strived to fit insurance groups with depository institutions into its bank holding company regulatory system. In this effort they have had to consider how to balance the conflicting pressures of banking regulation – focused on macro-economic stability, holding company source of strength for depositors and federal deposit insurance fund protection – with a completely different insurance business model that does not contribute to systemic risk and is focused on legal entity regulation for consumer protection.

Recent statements from the leadership of the Federal Reserve Board clearly indicate that they understand the necessity, and share the goal, of "tailoring" their regulatory activities to the subject of those activities. However, without changes in the statute, Federal Reserve officials are limited as to the amount of deference they can provide to state-based insurance regulation of insurance companies with savings and loan subsidiaries.

Federal Reserve Supervision of Insurance SLHCs

Until 2011, savings and loan holding companies (SLHCs) were regulated by the OTS. In 2011, pursuant to the Dodd-Frank Act, the supervisory responsibilities of the OTS were transferred to the Federal Reserve, and savings and loan holding companies were subjected to the Board's holding company supervision. That supervision was applied not just to the thrifts or banks within the group, but also across the entire group including its insurance operations with a focus on the SLHCs internal controls and corporate governance, as well as risk identification, measurement, and management. The Federal Reserve also has supervisory authority over entities designed by the FSOC as systemically important.

In congressional hearings and public forums leading to the enactment of the Insurance Capital Standards Clarification Act of 2014, an oft-repeated theme was that regulators should avoid using a one-size-fits-all approach to setting capital rules for financial companies under its jurisdiction. This was most typically reflected in the view that insurance companies should not be regulated like banks and subject to rules designed for banking. We agree with this approach; but recommend that supervision should not only be tailored to reflect the unique risk-based attributes of each sector, banking versus insurance, but also the unique attributes of the diverse range of business models and product lines within the insurance sector.

While the Federal Reserve has authority with respect to SLHCs and designated systemically important companies, it is important to note that there are distinct differences in these two categories of companies. SLHCs are subject to Federal Reserve jurisdiction because of the presence of a depository institution and because Congress abolished the OTS, not because the companies have been designated by the Financial Stability Oversight Council as potentially posing systemic risk to the U.S. financial system.

Congress passed with overwhelming support the Insurance Capital Standards Clarification Act of 2014, which allowed the Federal Reserve to avoid imposing on insurers capital standards designed for bank holding companies. The Federal Reserve is now trying to ramp up its understanding of insurance to evaluate various domestic and international proposals regarding how it should supervise insurance holding companies under its jurisdiction. Federal staff have spent considerable time and effort examining insurers, asking questions not only about their depository institutions and potential risks to the federal deposit insurance fund, but about many unrelated insurance and commercial activities as well. They are just doing their job, but the question for Congress is whether it is worthwhile for the Federal Reserve to be focused on examining well-capitalized and well-regulated insurance SLHCs. COUNTRY's experience suggests it is not.

We do not believe that Congress truly intended to create an additional layer of intensive Federal Reserve supervision of insurance for Main Street insurance operations. We fully respect the integrity of the Federal Reserve in carrying out its new responsibilities but would suggest that additional clarity from Congress regarding its intent under the Dodd-Frank Act could be helpful.

To the extent that the Federal Reserve imposes supervisory requirements on insurance holding companies under its jurisdiction, the Federal Reserve should focus on the holding company banking activities and risks and rely to the extent possible on state regulatory standards and oversite with respect to the insurance operations of the group. By doing so, the Federal Reserve would not need to try to replicate decades of sector-specific regulatory experience. Changing the Federal Reserve's focus, however, will require specific congressional direction and amendments to existing law.

State Insurance Regulation Preservation Act - H.R. 5059

COUNTRY applauds Representatives Keith Rothfus and Joyce Beatty for introducing H.R. 5059, the State Insurance Regulation Preservation Act. The bill would provide clear legal authority and guidance to assure that regulation of insurance savings and loan holding companies is appropriately tailored and gives due recognition to proven effective state-based insurance regulation. At the same time, it would provide emergency supervisory authority to the Federal Reserve if all else fails.

Scope

The bill would not impact the way the Federal Reserve regulates banks and thrifts that are not affiliated with insurers. Its purpose is only to curtail duplicative federal regulation of holding companies that are primarily insurance underwriters. The bill's definitions, in combination, would assure that only insurance savings and loan holding companies that are intensively regulated by the states are covered -- not all or even most savings and loan holding companies.

Tailored Regulation

The bill would provide important provisions to prevent duplicative reporting. For example, if a holding company is within the scope of the bill (i.e., it is an insurance SLHC), the Federal Reserve could require companies to report on core regulatory information such as the group's corporate structure, transactions between the company and its affiliates, financial reports, and capital holdings. That is sufficient to establish whether a company meets required capital levels. The Federal Reserve Board must have developed the examination framework in consultation with state regulators and must tailor examinations to the risk and activities of the business of insurance. If the insurance SLHC meets both applicable state and Federal Reserve capital standards, the Board would rely on state insurance regulators and would neither examine nor apply supervisory guidance to the SLHC. Federal Reserve supervision and exam authority would appropriately be limited to insurance SLHCs not meeting minimum capital requirements and material unregulated non-insurance subsidiaries, whose activities could possibly put the depository institution at risk.

Corrective Actions

Under the bill, if an insurance SLHC fails to maintain its minimum required capital, the Board would be required to provide a notice of noncompliance and require the company to submit, within 45 days, a plan to restore that capital. If the company fails to do so, the Board could then impose its supervisory and regulatory authority to the insurance SLHC.

Emergency Supervisory Authority

The bill would provide an additional Federal Reserve regulatory safety net in emergencies. The Board, after consultation with the state insurance regulators, would retain the ability to apply more intensive regulation, where the operations and activities of the insurance SLHC pose a serious and imminent risk to the financial safety and soundness of the subsidiary saving association.

Conclusion

H.R. 5059 embodies the Congressional intent of Dodd-Frank and the growing consensus that Federal Reserve Board regulation of insurance SLHCs should be better coordinated with, and governed by, proven effective state-based insurance regulation. At the same time, however, the bill would assure that the Federal Reserve Board has emergency powers to intervene to protect saving associations if all else fails.

We hope that COUNTRY's experience with Federal Reserve Board oversight is informative to policymakers. The Fed has an enormously important role to play in restraining inflation, promoting job growth, and monitoring broader macroeconomic financial stability. Having the Fed divert its resources to duplicating the oversight of state insurance regulation is truly suboptimal and inefficient. Let the states do their job, leave the Fed with emergency powers to fill in if there is a real threat to the federal bank deposit insurance fund, and let property-casualty insurers focus on serving our customers and maintaining our record levels of consumer satisfaction.

Accordingly, we look forward to working with Congress to enact this important, balanced and effective legislation.

J.D. POWER

Press Release

P&C Insurance Customer Satisfaction Driven by Good Communication, Not Speed, J.D. Power Finds

Record Catastrophic Losses Place P&C Insurer Focus Squarely on Management of Customer Expectations

COSTA MESA, Calif.: 22 Feb. 2018 — Overall customer satisfaction among homeowners filing property insurance claims has reached a new all-time high, despite record-high property losses following a spate of hurricanes, earthquakes and fires in North America. That's according to the J.D. Power 2018 U.S. Property Claims Satisfaction Study,SM released today, which finds that insurers that have achieved the highest levels of customer satisfaction have also been the most effective at managing customer expectations for the time it will take to settle claims.

"The last two years of record catastrophic losses have put P&C insurers to the test, and many have risen to the occasion, driving overall customer satisfaction levels to new highs," said **David Pieffer, Property & Casualty Insurance Practice Lead at J.D. Power.** "While that overall performance is a positive for the industry, there is wide variability in the ranges of performance among insurers in different regions of the country and between different service attributes. Particularly noteworthy, customer satisfaction in Texas and Florida—two of the areas hardest hit by hurricanes—show below-average results, spotlighting areas where there is still room for improvement among insurers."

Following are some of the key findings of the 2018 study:

- **Overall customer satisfaction reaches record high:** Overall satisfaction for property claims has reached an all-time high of 860 (on a 1,000-point scale) at the same time the personal lines segment has experienced record claims. This is the second consecutive year that property claims satisfaction levels are in line with auto claims satisfaction scores, which had historically trended higher. The bulk of this year's improvement is driven by non-weather-related claims, primarily related to water damage.

- **Managing time expectations becomes key driver of satisfaction:** The time it took to settle a claim is the single lowest-rated attribute in the study, with 1 in 7 respondents indicating that the claim took longer than expected. However, when time frames are properly managed, even groups that experience the longest time-to-settlement still rate their experience above the industry average of 8.45 (on a 10-point scale). Time-to-settle satisfaction ratings are 1.9 points lower when insurers miss customer timing expectations, even when the time frame is relatively short.

- **Areas hit hardest by weather events show declining satisfaction:** Texas and Florida show declining customer satisfaction scores in the immediate aftermath of major weather events. In both cases, the time required to estimate the damages is particularly affected. Claims related to hail storms in Texas, and high winds or storms in Florida, see this time nearly double to 10 days compared with five days for claims in these states not related to weather.

- **Outsourcing takes a toll:** The use of independent appraisers, which typically spikes when large catastrophic events occur, is associated with significantly lower customer satisfaction scores. However, interactions with the appraisers are not driving the lower scores; rather, insurance companies are not effectively incorporating appraisers into the claim process workflow as customers are most critical of key claim experience attributes such as time-to-settle; kept informed on claim; and thorough explanation of settlement.

Study Rankings

Amica Mutual ranks highest in property insurance claims experience for a seventh consecutive year, achieving a score of 895. **Chubb** ranks second with a score of 887, followed by **Erie Insurance** with a score of 884.

The U.S. Property Claims Satisfaction Study measures satisfaction with the property claims experience among insurance customers who have filed a claim for damages by examining five factors (listed in order of importance): settlement; claim servicing; first notice of loss; estimation process; and repair process. It is based on 6,572 responses from homeowners' insurance customers and was fielded between January and November 2017.

For more information about the U.S. Property Claims Satisfaction Study, visit http://www.jdpower.com/resource/us-property-claims-satisfaction-study.

See the online press release at http://www.jdpower.com/pr-id/2018020.

J.D. Power is a global leader in consumer insights, advisory services and data and analytics. These capabilities enable J.D. Power to help its clients drive customer satisfaction, growth and profitability. Established in 1968, J.D. Power is headquartered in Costa Mesa, Calif., and has offices serving North/South America, Asia Pacific and Europe. J.D. Power is a portfolio company of XIO Group, a global alternative investments and private equity firm headquartered in London, and is led by its four founders: Athene Li, Joseph Pacini, Murphy Qiao and Carsten Geyer.

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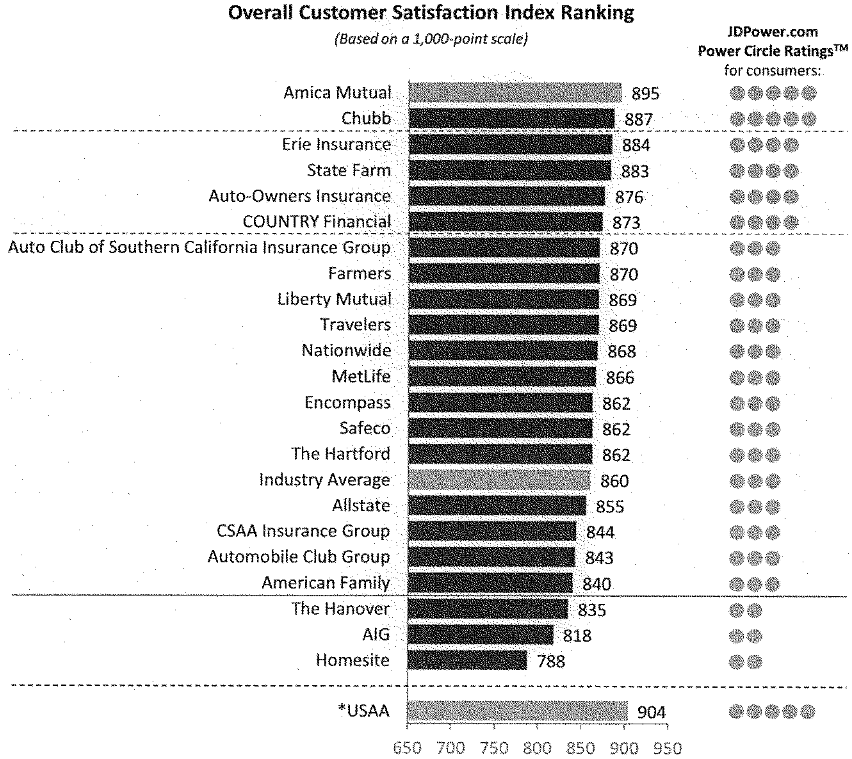
# # #
NOTE: Two charts follow.

J.D. Power
2018 U.S. Property Claims Satisfaction Study℠

Overall Customer Satisfaction Index Ranking

(Based on a 1,000-point scale)



Power Circle Ratings Legend
●●●●● *Among the best*
●●●● *Better than most*
●●● *About average*
●● *The rest*

**USAA is an insurance provider open only to U.S. military personnel and their families, and therefore is not included in the rankings. Included in the study but not award-eligible due to not meeting minimum sample requirements are Cincinnati Insurance and MAPFRE Insurance.*

Source: J.D. Power 2018 U.S. Property Claims Satisfaction Study℠

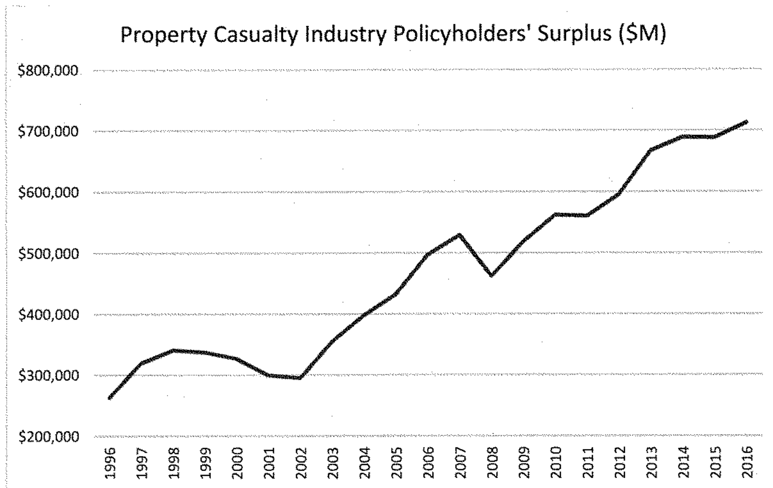
Charts and graphs extracted from this press release for use by the media must be accompanied by a statement identifying J.D. Power as the publisher and the study from which it originated as the source. Rankings are based on numerical scores, and not necessarily on statistical significance. No advertising or other promotional use can be made of the information in this release or J.D. Power survey results without the express prior written consent of J.D. Power.

J.D. Power
2018 U.S. Property Claims Satisfaction Study℠

Award-Eligible Insurance Companies Included in the Study

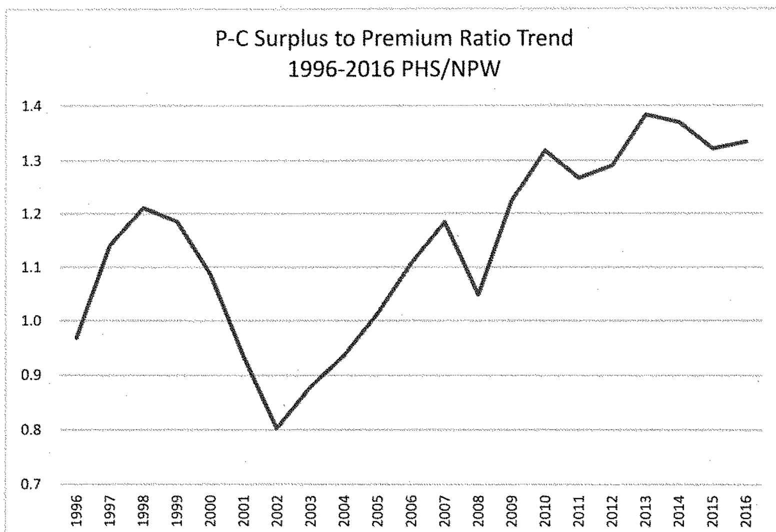
Company	CEO	Company Location
AIG	Brian Duperreault	New York, N.Y.
Allstate	Thomas Wilson II	Northbrook, Ill.
American Family	Jack Salzwedel	Madison, Wis.
Amica Mutual	Robert DiMuccio	Lincoln, R.I.
Auto Club of Southern California Insurance Group	John Boyle	Los Angeles, Calif.
Automobile Club Group	Joe Richardson, Jr.	Dearborn, Mich.
Auto-Owners Insurance	Jeffrey S. Tagsold	Lansing, Mich.
Chubb	Evan G. Greenberg	New York, N.Y.
COUNTRY Financial	Kurt Bock	Bloomington, Ill.
CSAA Insurance Group	Paula Downey	Walnut Creek, Calif.
Encompass	Thomas Wilson II	Northbrook, Ill.
Erie Insurance	Timothy NeCastro	Erie, Pa.
Farmers	Jeffrey Dailey	Woodland Hills, Calif.
Homesite	Fabian Fondriest	Boston, Mass.
Liberty Mutual	David H. Long	Boston, Mass.
MetLife	Steven Kandarian	New York, N.Y.
Nationwide	Stephen Rasmussen	Columbus, Ohio
Safeco	David H. Long	Boston, Mass.
State Farm	Michael Tipsord	Bloomington, Ill.
The Hanover	John C. Roche	Worcester, Mass.
The Hartford	Christopher Swift	Hartford, Conn.
Travelers	Alan D. Schnitzer	New York, N.Y.

Appendix 2



PHS Chart Source: S&P Global Market Intelligence

Appendix 3



PHS/NPW Chart Source: S&P Global Market Intelligence

Appendix 4

PROPERTY CASUALTY Market Concentration Analysis

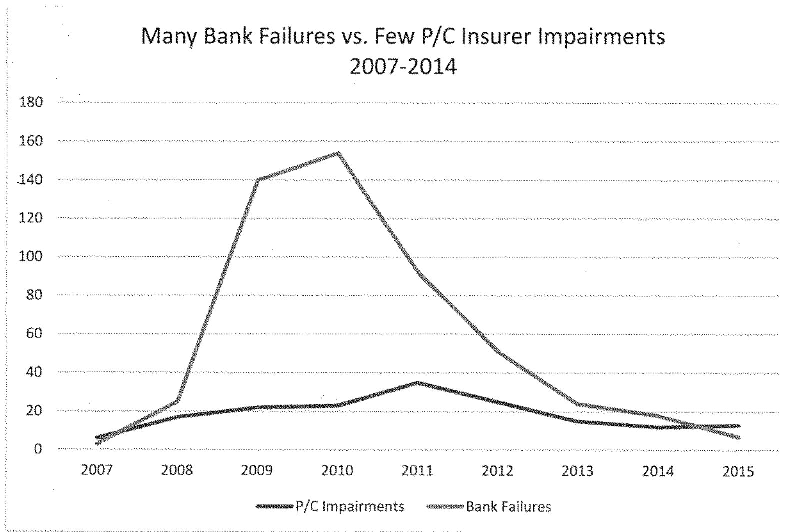
DOJ Considers Score of 1500 - 2500 to Be Moderately Concentrated, But Almost All Insurers Fall Well Below

Herfindahl-Hirschman Index (HHI) based on 2016 U.S. Total (all states and DC)

	HHI Indiv. Cos.	**Number of Indiv. Cos.**
Line		
Homeowners	291.3	879
Personal Auto	360.4	838
Commercial Multi-Peril	92.6	796
Workers Compensation	89.9	694
Medical Prof. Liability	200.5	326

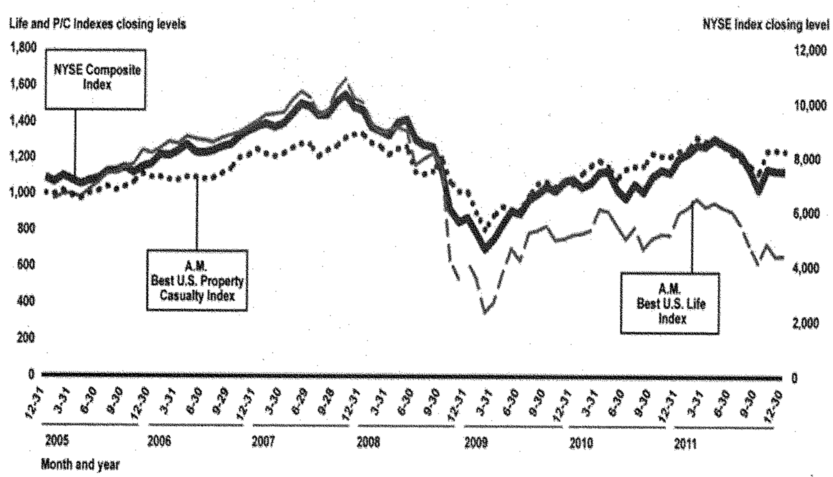
Notes:
The HHI takes into account the relative size and distribution of the firms in a market and approaches zero when a market consists of a large number of firms of relatively equal size. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.
Markets in which the HHI is between 1500 and 2500 points are considered to be moderately concentrated, and those in which the HHI is in excess of 2500 points are considered to be concentrated.
Source: NAIC Annual Statement Database via S&P Global Market Intelligence

Appendix 5



Source: A.M. Best data & research

Appendix 6



Source: GAO analysis of A.M. Best data on the A.M. Best U. S. Life and Property Casualty Indexes and the New York Stock Exchange Composite Index.

TESTIMONY OF MICHAEL MAHAFFEY

Chief Strategy & Risk Officer of Nationwide Mutual Insurance Company

On Behalf of Nationwide Mutual Insurance Company and the Insurance Coalition

Before the United States House of Representatives Financial Services Committee

Subcommittee on Housing and Insurance

Hearing on H.R. 5059, the "State Insurance Regulation Preservation Act"

Chairman Duffy, Ranking Member Cleaver, and Members of the Subcommittee, thank you for the opportunity to appear before you today. My name is Michael Mahaffey and I am the Chief Strategy & Risk Officer of Nationwide Mutual Insurance Company and its subsidiaries and affiliates (collectively, "Nationwide"). I am testifying on behalf of Nationwide but also represent the Insurance Coalition, a diverse group of insurers that are subject to both state insurance holding company supervision and Federal Reserve Board ("Federal Reserve") holding company supervision as savings and loan holding companies (SLHCs) due to their ownership of a thrift institution. I am here today to testify in support of H.R. 5059, and I would like to thank the bill's sponsors, Congressman Rothfus and Congresswoman Beatty who, along with Congressman Stivers, is one of our hometown Representatives.

As Nationwide's Chief Strategy Officer, I am responsible for facilitating the development and maintenance of a clearly articulated enterprise strategy that is consistent with Nationwide's vision and mission. As Nationwide's Chief Risk Officer, I am responsible for the establishment and maintenance of an enterprise risk management framework and function with the responsibility to identify, assess, monitor and manage all material and relevant risks within the Nationwide organization. In these capacities, I have had the opportunity to have continuous discussions and participate in numerous examinations with both Nationwide's lead-state supervisor, the Ohio Department of Insurance, and the Federal Reserve and its day-to-day examination teams at the Federal Reserve Banks. Therefore, I believe I can offer a helpful perspective on the inefficiencies in the supervisory environment faced by Nationwide and other insurance SLHCs, and how H.R. 5059 can maximize supervisory efficiency while avoiding gaps in supervision.

About Nationwide and its Supervisory and Regulatory Environment

Based in Columbus, Ohio, Nationwide is a Fortune 100 diversified financial services organization offering a wide range of insurance, annuity, investment and banking products and services. Of note, Nationwide is a highly-regulated financial institution across all aspects of its business.

Nationwide Mutual Insurance Company ("Nationwide Mutual") and its property and casualty insurance subsidiaries primarily underwrite personal automobile, homeowners and commercial insurance products. Nationwide Financial Services, Inc. ("Nationwide Financial"), an indirect subsidiary of Nationwide Mutual, develops and sells a diverse range of products, including individual annuities, private and public sector retirement plans and other investment products sold to institutions, life insurance and advisory services. In addition, Nationwide Financial provides banking products and services through Nationwide Bank, a federal savings bank and member FDIC.

Nationwide Mutual is the ultimate controlling parent of all entities in the Nationwide group of companies. As the ultimate controlling parent, Nationwide Mutual is registered as an insurance holding company system in the various states where it has domiciled insurance companies, with the Ohio Department of Insurance serving as the lead-state supervisor of the holding company system.[1]

By virtue of its ownership of Nationwide Bank, a thrift institution representing less than 3% of Nationwide's total asset size, Nationwide is also registered as an SLHC pursuant to Section 10 of the Home Owners' Loan Act of 1933 ("HOLA") thereby subjecting it an additional layer of holding company supervision by the Federal Reserve.[2]

In addition to the dual layers of state and federal holding company supervision noted above, Nationwide is subject to extensive supervision and regulation from various other regulatory bodies, including but not limited to the OCC, SEC, FINRA, Department of Labor, Internal Revenue Service, to name a few.

We support appropriate levels of supervision and regulation that protect our policyholders and the economy. We are not seeking to eliminate the role of the Federal Reserve in ensuring our safety and soundness. As a mutual organization, financial and operational strength is core to our business proposition – providing our policyholders with protection when they need it the most. Rather, we seek to ensure that our supervisory and regulatory regime provides an appropriate balance between the roles of the Federal Reserve and the state insurance supervisors, is proportional to the risks faced by our organization, and allows us to focus on the risks that are most material to our organization given our business composition. We believe that H.R. 5059 achieves this goal, and we strongly support this legislation.

A Brief History of Federal Reserve Supervision of Insurance SLHCs

Before I discuss H.R. 5059 specifically, I believe it would be helpful to explain the history of Nationwide's structure and supervisory environment and why we view this legislation as both necessary and a narrowly tailored solution to address a significant supervisory inefficiency.

Nationwide, as is the case with every other insurance SLHC, owned a thrift institution before the 2008 Financial Crisis. Like every other business in the U.S., we were affected by the crisis, and saw the devastating effects on families and businesses across the country. Nonetheless, Nationwide weathered the storm in a strong financial position, and we are proud of our ability to

[1] While the Ohio Department of Insurance serves as the lead-state supervisor of the Nationwide insurance holding company system, Nationwide also has insurance company subsidiaries that are subject to financial condition supervision and regulation in the following states of domicile: Arizona, California, Iowa, Michigan, New Jersey, New York and Texas. In addition, Nationwide is subject to state insurance regulation in all 50 states and the District of Columbia where its insurance companies are licensed to do business.

[2] Nationwide technically has four registered SLHCs: Nationwide Mutual Insurance Company, Nationwide Mutual Fire Insurance Company, Nationwide Corporation and Nationwide Financial Services.

continue to serve our policyholders in any economic environment. Nationwide neither sought nor accepted government funds during the crisis, and, to the best of our knowledge, we have never been viewed by any regulator as posing systemic risk to the U.S. financial system.

In response to the economic crisis, Congress enacted the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* ("Dodd-Frank"). Dodd-Frank eliminated the Office of Thrift Supervision and brought Nationwide Bank under OCC supervision. Dodd-Frank also brought insurance SLHCs like Nationwide under Federal Reserve supervision. Since July 21, 2011, Nationwide has been supervised on a group-wide basis by both the Ohio Department of Insurance and the Federal Reserve.

Despite significant supervisory and regulatory costs, Nationwide has purposefully opted to continue to offer competitively priced, reliable banking products. Nationwide's online bank represents a way to supplement the insurance services we provide to our life and property casualty members. These banking products and services augment our core insurance and financial products and services, creating additional value for our members. As an example, Nationwide Bank has created innovative solutions to deliver immediate access to insurance funds for our members in the wake of natural catastrophes, often at times when their access to a brick-and-mortar bank may be impaired. Whether utilizing the pre-paid claims cards in the aftermath of the Joplin tornados or supplying emergency debit cards to customers in the Northern California wildfires who had lost everything, these solutions provide access to critical funds precisely when they are needed most. Some insurers have divested their banks in light of the increased supervisory and regulatory costs associated with Federal Reserve supervision; however, we believe strongly that it is in the best interest of our customers (and indeed the banking system) to have access to affordable retail banking products from the strong insurance companies they trust.

We have consistently found Federal Reserve officials and Federal Reserve Bank examiners to be dedicated public servants who consistently strive to work collaboratively and thoughtfully with us. In addition to our appreciation of the Federal Reserve examiners, we also appreciate and have benefited from the addition of an insurance policy team at the Federal Reserve Board in Washington. Tom Sullivan, as the head of that team, and his entire staff have provided invaluable expertise on insurance and have been open and collaborative on issues facing us as an insurance SLHC.

However, despite the sincere efforts of a dedicated group of public servants at the Federal Reserve, we believe that our current supervisory environment is highly inefficient in a way that Congress did not intend. Specifically, we have learned a great deal since 2011 regarding how, in our view, the division of labor between the Federal Reserve and the States could function much more efficiently and in a manner more appropriately tailored to the risk profile of an insurer like Nationwide, while at the same time ensuring that the Federal Reserve can fulfill its statutory mandates to ensure that insurance SLHCs operate in a safe and sound manner and can serve as a source of strength to their depository institution subsidiaries. We believe that H.R. 5059 provides a means to that end.

Duplicative and Inefficient Holding Company Supervision and Regulation of Nationwide

I would first like to highlight that state insurance supervision and regulation is not limited to the individual insurance legal entities, and state insurance supervisors analyze and examine the financial condition and risk position of the holding company system as a whole. As I will describe in greater detail below, state insurance holding company system oversight is a well-developed area of prudential supervision focused on both individual insurance companies and the group.

Moreover, the States' emphasis on, and improvements to, their group-wide supervisory frameworks greatly intensified in the wake of the 2008 Financial Crisis in the same way that the Federal Reserve and other banking regulators re-evaluated the effectiveness of their group-wide supervisory frameworks during the same time-period.

I would also like to highlight that insurance SLHCs are the only Federal Reserve-supervised institutions that face dual holding company supervision by the Federal Reserve and another prudential regulator. While bank holding companies have regulators in addition to the Federal Reserve for their banking institutions, such as the OCC and the FDIC, only insurance SLHCs are subject to dual holding company supervision in addition to regulation of their thrift institutions by the OCC.

As both a state-supervised insurance holding company system and a Federal Reserve-supervised insurance SLHC, Nationwide has had to navigate the evolution of financial services supervision and regulation and, more specifically, group-wide holding company supervision over the past decade. This has put us in the unique position of being able to highlight where Federal Reserve holding company supervision is unintentionally inefficient and not appropriately tailored to the risks presented by an insurance holding company system.

Highlighted below are several instances where Federal Reserve holding company supervision has produced unintentional inefficiencies vis-à-vis state insurance holding company supervision:

Prudential Financial Examinations. State insurance supervisors and the Federal Reserve have overlapping statutory responsibility to examine the operating and financial condition of insurance groups, including enterprise risks posed by any entity in the organization. State insurance holding company laws provide the departments of insurance with the authority and responsibility to conduct examinations to ascertain the financial condition, including enterprise risk to the insurer, by the ultimate holding company, any entity or combination of entities in the insurance holding company system, and the insurance company on a consolidated basis.[3] Likewise, the Federal Reserve has the same authority and responsibility to conduct examinations to monitor the operating and financial condition of Insurance SLHCs and their subsidiaries, and to monitor risks (and systems for controlling risks) of Insurance SLHCs that pose a threat to (i) the safety and soundness of the SLHC and its thrift institution, or (ii) financial stability of the U.S.[4] Here, the authority and responsibility for state insurance supervisors and Federal Reserve

[3] See e.g., Ohio Revised Code §§ 3901.35(A)(1) and 3901.07.
[4] See 12 U.S.C. § 1467a(b)(4).

to conduct examinations are almost entirely duplicative, both allowing for the consideration of any entity in the organization and the organization on a consolidated basis.

Risk-Focused Approach to Examinations. State insurance supervisors and the Federal Reserve have adopted nearly identical risk-focused supervisory frameworks that both begin with the identification of the inherent risks of the group, then an evaluation of controls in place to mitigate those risks, and finally, a supervisory plan to address residual risks.[5] Further, the Federal Reserve has developed a consolidated supervisory framework for larger financial institutions with supervisory expectations focused on capital and liquidity planning and positions, corporate governance, enterprise risk management, internal audit and internal controls, and business recovery and resiliency.[6] At the same time, state insurance departments have various laws, regulations, reporting requirements and financial analysis and examination procedures to monitor and assess the insurance group's corporate governance, enterprise risk management and solvency, internal audit function, financial reporting controls, related-party transactions and business continuity planning.[7] Again, there is significant overlap here.

Heightened Focus on Information Technology (IT) and Cybersecurity. As part of their financial conditions examinations, state insurance departments conduct intensive examinations of IT and cybersecurity risk and the systems and controls in place to manage those risks.[8] In addition, the States have developed a multitude of laws and regulations regarding data security, safeguarding customer information, cybersecurity and data breach notification. At the same time, the Federal Reserve has placed a heightened focus on IT and cybersecurity and is conducting continuous examinations across the industry using its distinct examination manuals and assessment tools that are duplicative and potentially inconsistent with state laws.[9] Today, we are subjected to numerous duplicative and costly federal and state cyber examinations on an annual basis from various regulators (state insurance departments, Federal Reserve, OCC, FINRA, SEC).

Ability to Require Corrective Actions. Both the state insurance departments and the Federal Reserve have the ability to require insurance holding companies to take corrective actions to address perceived corporate governance deficiencies, risk management deficiencies and internal control deficiencies. Among other actions, state insurance departments have the ability to require insurance companies to increase capital and surplus, suspend dividends, correct corporate

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[5] See Supervision and Regulation (SR) 97-24, *Risk-Focused Framework for Supervision of Large Complex Institutions*, October 27, 1997, and the National Association of Insurance Commissioner (NAIC) *Financial Condition Examiners*, Section 2, "Risk-Focused Examination Process".

[6] See Supervision and Regulation (SR) 12-17, *Consolidated Supervision Framework for Large Financial Institutions*, December 17, 2012.

[7] See the NAIC Corporate Governance Annual Disclosure Model Act (#305) and Model Regulation (#306); Risk Management and Own Risk and Solvency Model Act (#505); Annual Financial Reporting Model Regulation (#205); Insurance Holding Company System Model Regulatory Act (#440) and Model Regulation (#450); and the NAIC *Financial Condition Examiners Handbook* and *Financial Analysis Handbook*.

[8] See the NAIC *Financial Condition Examiners Handbook*, Exhibit C "Evaluation of Controls in Information Technology".

[9] See *Federal Financial Institution Examination Council (FFIEC) IT Examination Handbook* and *Cybersecurity Assessment Tool*.

governance deficiencies in a manner acceptable to the commissioner and withdraw from certain investments and investment practices.[10] In a similar manner, the Federal Reserve utilizes informal supervisory findings referred to as Matters Requiring Attention (MRAs) or Matters Requiring Immediate Attention (MRIAs) to drive institutions to correct perceived deficiencies and align with Federal Reserve supervisory guidance.

The Need for a Tailored Supervisory Approach

In addition to the overlap noted above, it has been our experience, and the experience of similarly situated insurance SLHCs, that the Federal Reserve has not appropriately tailored its supervisory framework for these institutions to account for the fact that they are already subject to extensive group-wide supervision by the state insurance departments. Further, because these institutions are predominantly insurance organizations, the application of a supervisory framework on them imported from bank holding company supervision results in a substantial amount of board of directors and management time and resources devoted to educating the Federal Reserve and Federal Reserve Bank examiners on the differences between insurance and banking, and how applying their supervisory framework to insurance activities is often a poor fit.

Highlighted below are various ways in which we believe the Federal Reserve supervisory approach is not proportional to safety and soundness risks at insurance SLHCs:

Treatment of Insurance SLHCs as Large Banking Organizations. The Federal Reserve treats insurance SLHCs with over $50 billion in assets as "Large Banking Organizations" and subjects them to a heightened consolidated supervisory framework that utilizes a multitude of discovery reviews, targeted inspections, enhanced continuous monitoring activities, and an annual supervisory ratings assessment.[11] These activities occur throughout an annual supervisory cycle, such that insurance SLHCs are continuously subject to some level of Federal Reserve examination activity in addition to concurrent state insurance department financial analysis requests and financial condition examinations.

We believe it is inappropriate to treat insurance SLHCs as "Large Banking Organizations" and subject them to the same level of oversight as similarly-situated bank holding companies. Unlike bank holding companies, insurance SLHCs are already subject to an extensive system of group-wide supervision by the state insurance departments.

To illustrate the issue, Nationwide had $236 billion in total consolidated assets as of year-end 2017 with Nationwide's thrift activities representing just 3% of the organizations assets. Nevertheless, the Federal Reserve supervisory regime treats Nationwide in the same manner as a similarly-sized bank holding company despite the Ohio Department of Insurance already performing extensive group-wide supervisory analysis and activities and the fact that Nationwide is predominantly an insurance organization (not a banking organization).

[10] See NAIC Model Regulation To Define Standards And Commissioner's Authority For Companies Deemed To Be In Hazardous Financial Condition (#385).
[11] Supervision and Regulation Letter (SR) 12-17, *Consolidated Supervision Framework for Large Financial Institutions*, December 17, 2012.

***Bank-centric Supervisory Guidance*:** Because Nationwide is predominantly an insurance organization, we are understandably focused on managing insurance-related risks as they are most material to our organization. As one of the country's largest property and casualty insurance companies, we have extensive experience and capabilities to manage property and casualty business risks, including catastrophe risk, underwriting risk, and product pricing risk. In addition, as one of the country's largest providers of life insurance and annuity products, we have extensive experience and capabilities to manage life insurance business risks, such as mortality risk, morbidity risk and longevity risk. Further, because we invest policyholder premiums to match the liabilities associated with both our property and casualty and life insurance and annuity products, we have extensive experience and capabilities to manage investments risks, such as credit and equity risk. Moreover, our primary insurance holding company supervisor, the Ohio Department of Insurance, has extensive experience analyzing, assessing and examining our risk management and control systems for these risks. Thus, it is critical to Nationwide that we are able to devote the appropriate amount of time and resources to managing these risks, including investing in people and capabilities that make us a stronger insurance organization – this is where we will truly benefit our policyholders while at the same time enhancing our ability to serve as a source of strength to our thrift institution.

The Federal Reserve and its examiners, on the other hand, have historically been banking regulators with extensive experience analyzing bank-specific risks, such as liquidity risk associated with a "run on the bank scenario", interest rate risk associated with sizeable residential or commercial lending portfolios, payment systems risk associated with being a financial intermediary, among others. Therefore, the supervisory guidance and expectations that the Federal Reserve has developed for managing these risks contemplate how they would impact and be applied to a banking organization. To date, the Federal Reserve has extended nearly 200 pieces of supervisory guidance to SLHCs, including insurance SLHCs, but has not provided any clear indication that it would apply this guidance to the business of insurance in an appropriately tailored manner, or how it would evaluate insurance SLHCs using this guidance in consultation and coordination with the state departments of insurance.

Due to the intensive nature of Federal Reserve supervision and examinations, Nationwide's board of directors, senior management and all other associates spend a substantial amount of time and resources reviewing, analyzing and implementing Federal Reserve supervisory guidance that was designed by bank regulators, for banks, to manage bank-centric risks. Further, we devote a substantial amount of time and resources responding to examinations and information requests related to bank-centric supervisory guidance. Because the state insurance departments already appropriately manage the risks associated with operating a substantial insurance organization through various forms of supervision, regulation and examination, this Federal Reserve overlay of bank-centric supervisory expectations results in an efficient use of time and resources without further contributing to our safety and soundness. In fact, these resources would be more appropriately devoted to continuing to manage our most material and relevant risks; that is, insurance risks which are directly within the purview of the state insurance departments. This would further the Federal Reserve's interest in ensuring our safety and soundness while protecting policyholders.

We do not object to appropriate levels of supervision and regulation; however, we seek to ensure that any supervision and regulation is fit for the purpose for which it was designed, and is appropriately tailored and scaled to the activity being supervised and regulated. We believe that Federal Reserve supervision is not appropriately tailored to the risks posed by insurance SLHCs in light of the extensive state insurance supervision already faced by these institutions, which supervision has been designed over many years to address the risks associated with managing a significant insurance holding company system. Moreover, we believe that the overlay of Federal Reserve supervision does not further contribute to our safety and soundness in a manner that justifies the significant amount of time and resources needed to navigate bank-centric holding company supervision.

Support for a H.R. 5059 and the Need for a Legislative Solution

We do not believe that in passing Dodd-Frank, Congress intended to force insurance companies to sell their thrifts. We also do not believe that Dodd-Frank intended for the Federal Reserve Board to place the same supervisory demands on a $230 billion insurance company with a small thrift, which is already subject to extensive state insurance holding company supervision, as $230 billion bank holding company predominantly engaged in banking and other financial activities.

We greatly appreciate Congress' longstanding commitment to the state system of insurance regulation, and the thoughtful, bipartisan approach this body has taken on this issue in the past. We very much appreciate Congress' action on the 2014 Insurance Capital Standards Clarification Act (the "2014 Act"), which passed the House and the Senate unanimously. H.R. 5059 would work in concert with the 2014 Act because it helps to ensure that any capital standards promulgated by the Federal Reserve for insurance SLHCs are appropriately tailored to the business of insurance. H.R. 5059 does not in any way affect the Federal Reserve's authority to establish capital requirements for Nationwide or any other insurance SLHCs. Rather, the bill addresses a very distinct concern – the inefficient, disproportionate, and inappropriately tailored nature of day-to-day supervision of insurance SLHCs in light of the fact that these institutions already face extensive group-wide supervision and regulation from the state insurance departments.

I've summarized below how H.R. 5059 addresses this issue while preserving the ability of the Federal Reserve to carry out its statutory mandates:

- H.R. 5059 preserves the role of the state insurance department as the primary regulator of insurance SLHCs and, provided the insurance SLHC continues to meet state capital standards and any group capital standards promulgated by the Federal Reserve pursuant to the 2014 Act, it would direct the Federal Reserve to rely exclusively on the state insurance departments for routine examinations and information requests related to insurance SLHCs. The Federal Reserve would be expected to rely on its broad information-sharing abilities with the state insurance supervisors, the OCC, the SEC and other prudential regulators to continue to monitor the operations of the insurance group.

- Importantly, H.R. 5059 provides the Federal Reserve with authority to step-back in as the day-to-day supervisor if an insurance SLHC fails to continue to satisfy state capital standards and any group capital standards promulgated by the Federal Reserve pursuant to the 2014 Act. Further, it provides the Federal Reserve with emergency authority to resume its role as a day-to-day supervisor of an insurance SLHC, even if capital standards are being satisfied, if the Federal Reserve reasonably determines that the activities of the insurance SLHC pose a serious and imminent risk to the financial safety and soundness or stability of the thrift institution.

- Additionally, H.R. 5059 leaves intact the Federal Reserve's direct examination authority over material subsidiaries that do not have a primary prudential regulator. This would serve to prevent regulatory arbitrage by allowing the Federal Reserve to fill any potential gaps in supervision. Moreover, it will serve to avoid another AIG Financial Products situation because any material subsidiary that is engaged in risky financial activities will be able to be easily identified and the Federal Reserve will continue to have direct examination authority over that entity.

- Insurance SLHCs would also be expected to file certain regulatory reports with the Federal Reserve so they can monitor organizational changes, identify material subsidiaries, monitor transactions between the thrift and its affiliates, and determine compliance with Federal Reserve capital standards. Because they will be developed by the Federal Reserve, these regulatory reports will be able to demonstrate to the Federal Reserve continued compliance with its required group capital standards. In addition, these reports will provide the Federal Reserve with a holistic view of the enterprise, and they can be used in conjunction with the Federal Reserve's relationships and information-sharing abilities with other functional regulators.

In short, H.R. 5059 allows the Federal Reserve to monitor solvency at insurance SLHCs by imposing capital standards; however, it preserves the role of the state insurance department to serve as the day-to-day supervisor. Further, it preserves the ability of the Federal Reserve to monitor and address other risks and concerns through its relationships and information-sharing abilities with the primary prudential regulators of these insurance holding companies. In addition, it would provide the Federal Reserve the ability to step-in if reasonably necessary using its emergency authority.

We believe this legislation strikes an appropriate balance between the Federal Reserve's statutory duty to ensure the safety and soundness of an insurance SLHC while leveraging the extensive work already performed by the state insurance supervisors as holding company supervisors. In addition, H.R. 5059 continues to preserve the primacy of the States as the regulators of insurance under the McCarran-Ferguson Act.

Conclusion

Mr. Chairman, in closing, I would like to add that we recognize that any legislation that attempts to solve one regulatory issue may create unintended consequences. It is critically important to

Nationwide, and I know to all the members of this subcommittee, that this legislation address regulatory inefficiencies without creating any regulatory gaps or inequities. We believe that a bipartisan solution to this issue is critical, and while we support the legislation in its current form, we also support necessary changes to improve the bill and increase its bipartisan support. We look forward to providing additional input as this process unfolds, and we greatly appreciate the opportunity to testify today.

TESTIMONY OF DANIEL SCHWARCZ

Professor of Law, University of Minnesota Law School

before the

United States House of Representatives

Committee on Financial Services

Subcommittee on Housing and Insurance

regarding "Legislative Review of H.R. 5059, The State Insurance Regulation Preservation Act"

March 7, 2018

Chairman Duffy, Ranking Member Cleaver, and members of the Subcommittee, thank you very much for this opportunity to discuss The State Insurance Regulation Preservation Act. The Bill is motivated by the sensible and important goal of reducing regulatory overlap and unnecessary compliance burdens for U.S. insurers. However, I have substantial concerns that the Bill's ultimate impact would be to undermine the interests of American taxpayers and increase the prospect of future financial instability.

In my testimony today, I will explain this concern in four parts. First, I will suggest that H.R. 5059 violates the core principle that the owners of federally-insured banks must be subject to effective consolidated oversight at the federal level. If a financial conglomerate chooses to benefit from the unique privileges that come along with owning a federally-insured depository institution, then it must be subject to umbrella supervision at the federal level to ensure that this privilege is not exploited.

Second, my testimony will emphasize that H.R. 5059 is premised on the flawed assumption that state insurance regulators' supervision of financial conglomerates is effective and time-tested. In fact, deficiencies in state insurance regulators' group level supervision helped contribute to the 2008 crisis. And though state insurance regulators have indeed made important improvements in their umbrella oversight of insurance groups, these recent reforms remain largely untested and importantly limited.

Third, I will show how H.R. 5059 creates the prospect for exactly the same type of regulatory arbitrage that helped cause the 2008 financial crisis. For instance, as currently drafted, the Bill would allow any large bank or thrift holding company to completely avoid federal oversight simply by causing its top tier holding company to acquire a license from a single state to sell insurance.

Finally, I will suggest that H.R. 5059 is legislation in search of a problem. In particular, I have seen limited evidence that the Federal Reserve's supervision of insurance-focused Savings and Loan Holding Companies ("SLHC"s) interferes with traditional state insurance regulation or imposes excessive compliance burdens on firms.

(1) H.R. 5059 violates the fundamental principle that bank owners must be subject to effective consolidated oversight at the federal level.

Federally insured depository institutions such as commercial banks and thrifts ("banks") enjoy a unique federal guarantee that protects their primary creditors (depositors) against default risk. This explicit federal safety net both undermines ordinary market discipline for banks and creates the risk that the financial consequences of their incaution will ultimately be borne by the federal government, and therefore U.S. taxpayers. A central goal of bank supervision and regulation is to mitigate this inevitable moral hazard of federal deposit insurance.

To accomplish this objective, banking oversight must meet two basic principles. First, it must substantially involve federal supervisors. Such federal oversight of banks is necessary because the federal government bears the underlying risk of banks' failure. Only federally-accountable actors have the appropriate incentives to monitor and mitigate that risk. Consistent with this principle, state-chartered depository institutions are supervised both by their chartering state and by a federal regulator.

Second, effective oversight of banks requires umbrella supervision of their holding companies and affiliates. The risks faced by any individual bank are inherently linked to the stability and health of the financial conglomerate within which it is situated.[1] This follows naturally from the fact that financial conglomerates generally manage risk on an enterprise-wide basis.[2] Perhaps even more importantly, banks are naturally susceptible to the reputational troubles of their affiliates. Uninsured depositors that become nervous about the financial health of a bank's affiliates are prone to immediately withdraw their deposits. In this way, even apparent problems experienced by a bank's affiliates or holding companies can undermine the financial stability of the bank itself.[3]

These two principles of regulatory design have, at least formally, been a part of U.S. financial regulation since the mid-Twentieth Century. But in the years leading up to the 2008 financial crisis, these principles were violated in practice, contributing directly to the failure of American International Group ("AIG"). During this time, AIG was a SLHC and therefore formally subject to group supervision by the federal Office of Thrift

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[1] *See* International Association of Insurance Supervisors (IAIS) Core Principles 23 (describing as a core principle of insurance regulation that "[t]he supervisor supervises insurers on a legal entity and group-wide basis.").
[2] For recent evidence of the importance of such group-wide risk management among life insurers, see Greg Niehaus, *Managing Capital Via Internal Capital Market Transactions: The Case of Life Insurers*, 85 J. RISK & INS. 69 (2018).
[3] Umbrella supervision of banks' holding companies and affiliates is important for an independent reason. Because banks enjoy federal insurance, they operate as a cheap source of funding that holding companies and affiliates may improperly exploit.

Supervision ("OTS"). Unfortunately, OTS was a notoriously lax regulator that focused its supervisory efforts almost exclusively on individual thrifts within SLHCs, rather than on group-wide risks.[4] A central explanation for OTS's lax regulatory approach was that banks could easily "shop" for their preferred regulator by altering their charter. It is for precisely this reason that Dodd-Frank eliminated OTS and transferred responsibility for supervision of SLHCs to the Federal Reserve.

H.R. 5059 would not only undo the progress made in Dodd-Frank, but it would make matters worse by formally eliminating federal group-level supervision of certain bank holding companies. In particular, H.R. 5059 would exempt "insurance savings and loan holding companies" ("ISLHC"s)[5] from group-wide supervision by the Federal Reserve so long as they met certain capital requirements. As a result, the Federal Reserve would no longer assess ISLHCs' group-level risk management, corporate governance, and internal controls. The bill would also strip the Federal Reserve of its authority to require ISLHCs to regularly report their consolidated financial information to the agency.

In the place of such umbrella oversight by the Federal Reserve, ISLHCs would be regulated almost exclusively by state insurance departments. As discussed in the next

[4] See Gov't Accountability Office, Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration (2007) (describing the OTS's relative lack of expertise in supervising financial activities that did not involve activities traditionally engaged in by thrifts, such as credit default swaps); Causes of the Recent Financial and Economic Crisis, Before the Fin. Crisis Inquiry Comm'n, (Sept. 2, 2010) (statement of Chairman Ben S. Bernanke) (noting that OTS's supervision of AIG's derivatives activities in its financial-products unit was extremely limited in practice).
[5] The Bill defines an ISLHC as "(i) a top-tier savings and loan holding company that is an insurance underwriting company" or "(ii) a savings and loan holding company that held 75 percent or more of its total consolidated assets in an insurance underwriting company or insurance underwriting companies, other than assets associated with insurance for credit risk, during the 4 most recent consecutive quarters..." In an apparent effort to include one specific company as an ISLHC even if it does not meet the above criteria, the definition also categorizes as an ISLHC a "(iii) a top-tier savings and loan holding company that— (I) was registered as a savings and loan holding company before July 3 21, 2010; and II) is a New York not-for-profit corporation formed for the purpose of holding the stock of a New York insurance company."

section, there are good reasons to be skeptical about the effectiveness of state insurance regulators' group supervisory processes. But even assuming for the moment that state insurance departments are generally effective group-level supervisors, such supervision is fundamentally ill-suited to protect federally-insured depository institutions. State insurance departments simply do not have the appropriate incentives to protect banks from group level risk, as they do not bear the consequences of losses to the Deposit Insurance Fund. It is the federal government, not the states, that backs the Deposit Insurance Fund and that must make whole the insured depositors of a failed bank.

Nor do state insurance regulators have any expertise or experience with understanding how instability within a holding company can impact banks, as opposed to insurance companies. For instance, reputational risk is unlikely to quickly spread to the insurance firms of a financial conglomerate, as most policyholders cannot withdraw their funds on demand. Insurance group supervision is therefore naturally focused largely on transactions between individual insurers and their affiliates or holding companies. By contrast, the asset-liability mismatch inherent in banking means that group level supervision must pay particular attention to reputational risk, which can infect an otherwise healthy affiliate bank quickly and dramatically.

As state insurance regulators often emphasize, the regulation of insurance companies is, in many ways, fundamentally different than the regulation of banks. For this very reason, insurance-focused firms that choose to own banks cannot be regulated effectively at the group level solely by state insurance regulators. Yet this is exactly what H.R. 5059 would accomplish.

The provisions in H.R. 5059 reinstating the Federal Reserve's authority over ISLHCs that drop below specified capital standards do little to address these concerns.[6] Although group capital requirements are an essential component of effective group-wide regulation, they are well understood to be a lagging indicator of financial distress. Indeed, many of the banking entities that failed or nearly failed in the 2008 crisis reported healthy levels of capital just months before the crisis hit. There are a variety of reasons why capital is a lagging indicator of financial distress, including the fact that many assets are difficult to value and managers often have strong incentives to delay recognizing losses.[7] Whatever the explanation, though, the implications for H.R. 5059's backstop are clear: by the time this backstop were triggered, the underlying ISLHC's problems would already be substantial and pose potential losses to the Deposit Insurance Fund.

(2) State Insurance Regulators' Group Supervisory Processes are Limited and Untested

As suggested by the name of H.R. 5059 – "The State Insurance Regulation Preservation Act" – the Bill is premised on the idea that state insurance regulators adequately regulate ISLHCs. Historically, however, state insurance regulation has been directed almost exclusively at individual insurance entities within a larger financial conglomerate, rather than their holding companies or affiliates. Indeed, every core element of state insurance regulation – including risk-based capital rules, reserve requirements, licensing requirements, investment restrictions, and financial monitoring –

[6] The Federal Reserve's supervision of the ISLHC can also be reinstated if the agency finds that the ISLHC poses "a serious and imminent risk to the financial safety and soundness or stability of the [ISLHC's] subsidiary saving association." But it is nearly impossible to understand how the Federal Reserve could invoke this "emergency supervisory authority" on a timely basis when it is not actively supervising the ISLHC and the ISLHC's reported capital levels appear sufficient.
[7] Daniel K. Tarullo, Banking on Basel: The Future of International Financial Regulation 171-72 (2008).

is applied solely to individual operating insurers, and not to their broader financial conglomerates.[8]

In fact, the absence of effective group-level supervision by state insurance regulators was partially responsible for AIG's collapse in 2008.[9] AIG's failure was attributable to two core elements of its operations: (1) its Credit Default Swaps ("CDS"s) business and (2) its securities lending operations. AIG's CDS operations were conducted out of a non-insurance affiliate, AIG Financial Products, and involved products that were not classified as insurance and arguably could not have been so classified as a result of federal law.[10] AIG also conducted its ill-fated securities lending program through several non-insurance affiliates. But in contrast to its CDS operations, AIG's securities lending programs directly implicated the company's insurers, whose securities were lent to outside firms. Had the federal government declined to bail out AIG, there is a good

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[8] *See* Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U. CAL. IRVINE L. REV. 537 (2015); Patricia A. McCoy, *Systemic Risk Oversight and the Shifting Balance of State and Federal Authority Over Insurance*, 5 U. CAL. IRVINE L. REV. 1389 (2015); Kenneth Abraham & Daniel Schwarcz, Insurance Law and Regulation: Cases and Materials (6th ed. 2015). To illustrate, at the end of 2014, MetLife included 359 subsidiaries in 50 different countries. Many of these subsidiaries operated within the United States, and only a subset of these subsidiaries were licensed insurance companies that were subject to state insurance regulation. These individual insurance entities, moreover, were regulated by numerous different states, including New York, Connecticut, Delaware, Rhode Island, and Missouri. All of the traditional tools of state solvency regulation were independently directed at each of these insurance entities, rather than the consolidated MetLife enterprise. *See* Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc. (Dec. 18, 2014).

[9] As discussed above, the OTS also failed in its efforts to prevent AIG's collapse.

[10] The Commodities Futures Modernization Act of 2010 limited the authority of the SEC and CFTC to regulate CDSs. Whether it also limited states' powers to regulate these instruments, to the extent that they constituted insurance, was less clear. In fact, in the midst of the 2008 crisis, New York proposed regulating certain CDSs – where the purchaser owned the underlying instrument – as insurance products. See Testimony of Eric Dinallo, New York State Insurance Commissioner, before the House Agriculture Committee, Nov. 23, 2008 (testifying "the insurance regulator for New York is a relevant authority on credit default swaps," because "[w]e believe . . .[they are] insurance."). New York eventually withdrew the proposal as it became clearer that a more comprehensive solution was being contemplated at the federal level.

chance that its insurers would have directly felt the consequences of these risky securities lending transactions.[11]

State insurance regulators' failure to prevent AIG's collapse revealed two very different limitations in their group supervisory processes. First, it demonstrated that a basic assumption of state insurance regulation – that an insurer's financial health could be isolated from its non-insurance affiliates and parent companies – was incorrect. It was based on this assumption that state regulators had historically ignored group regulation. Yet there is little doubt that the failure of AIG Financial Products – a foreign non-insurance affiliate – ended up jeopardizing the financial stability of the company's insurers. Indeed, before the federal government bailed out AIG, various proposals contemplated the possibility that the assets of AIG's insurers might be used to support its troubled parent company and non-insurance subsidiaries.[12]

Second, and perhaps even more importantly, AIG's collapse revealed deficiencies in state insurance regulators' capacity to conduct effective umbrella oversight *even when they were attempting to do so*. In contrast to AIG's CDS operations -- which were clearly beyond the intended regulatory scope of state insurance regulators – AIG's securities lending operations were ostensibly being overseen by state regulators in the years leading up to the crisis. This is hardly surprising: unlike CDSs, securities lending operations are common among life insurers, and deeply intertwined with the broader nature of life insurance operations, which generally require insurers to own long-term securities that can profitably be lent out to other actors within the financial system.

[11] *See* Anna Paulson & Robert McDonald, *AIG in Hindsight*, 29 J. ECON. PERSP. 81 (2015).
[12] *See* American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation, Hearing before the Senate Committee on Banking, Housing and Urban Affairs, 111th Cong, 1st Sess. 56–59 (2009) (statement of Eric Dinallo, Superintendent, New York State Insurance Department).

State insurance regulators nonetheless failed to fully appreciate or mitigate the risks of AIG's securities lending operations until it was too late. As the non-partisan U.S. Government Accountability Office found, "prior to mid-2007, state regulators had not identified losses in the securities lending program and the lead life insurance regulator had reviewed the program without major concerns."[13] State insurance regulators failed to diagnose these problems with AIG's securities lending program in a timely fashion due to deficiencies in their group-oversight processes. Because AIG operated this program through its non-insurer affiliates, no individual insurance regulator took primary responsibility for carefully scrutinizing it.[14] Just as importantly, state regulators failed to appreciate the magnitude of the securities lending issues they discovered at AIG because they did not link them to the firm's CDS operations, which also exposed AIG to massive risks linked to mortgage-backed securities.[15]

To be sure, state insurance regulators have not ignored the deficiencies in their group oversight that were laid bare in the 2008 crisis. In recent years, state insurance regulators have made substantial and meaningful efforts to shore up their efforts at group supervision. Perhaps most importantly, the NAIC developed a new Model Holding Company Act that seeks to extend state regulators' purview to insurers' holding

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[13] U.S. Gov't Accountability Office, GAO-11-616, Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc. 13 (Sept. 2011); See also Congressional Oversight Panel, The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy 45-46 ("In mid-2007, as part of its examination process, Texas, the lead regulator for the firm's life insurance subsidiaries, discovered that AIG was purchasing RMBS with its securities lending collateral (a practice that began in late 2005).").

[14] *See* Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U. CAL. IRVINE L. REV. 537 (2015); The Role of Derivatives in the Financial Crisis: Hearing Before the Fin. Crisis Inquiry Commission, 111th Cong. 206 (2010) (testimony of Eric R. Dinallo, Former Superintendent, N.Y. State Ins. Dep't) (admitting that AIG's securities-lending operations "le[d] to . . . regulatory assignment questions"); Federal Insurance Office, How to Modernize and Improve the System of Insurance Regulation in the United States 40 (2013) (noting that the "inability of [state regulators' solo entity focus] to account for consolidated supervision was evident during the financial crisis, particularly in the case of AIG").

[15] *See* Daniel Schwarcz, *A Critical Take on Group Regulation of Insurers in the United States,* 5 U. CAL. IRVINE L. REV. 537 (2015).

companies and non-insurance affiliates. State insurance regulators have also begun implementation of the Own Risk and Solvency Assessment (ORSA), which sizable insurance groups must file with their lead state regulator.

Despite these advances, state supervision of insurance groups is still in its infancy, and continues to face various important practical and legal challenges. First, states' legal authority to conduct effective group supervision remains questionable. Although state law on this issue varies, many state insurance departments have limited direct authority over non-insurance affiliates or insurance holding companies.[16] For instance, most state insurance departments can generally only compel insurance entities, but not parent companies or non-insurance affiliates, to submit regular periodic reports.[17] Perhaps even more importantly, states generally have no authority to fine or otherwise sanction non-insurer affiliates, and they can only sanction executives of a holding company system for fraud or for involvement in certain improper transactions within the holding company system.[18] Finally, states' examination authority over non-insurance affiliates is expressly limited to analyzing whether these entities pose enterprise risk to state licensed insurance companies, rather than to non-insurance affiliates (such as thrifts) within the holding company.[19]

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[16] The National Association of Insurance Commissioners has amended its model holding company law twice in recent years: in 2010 and 2014. Only some states have adopted the 2014 revisions.
[17] There are two primary exceptions to this general principle. First, states can indeed demand that parent companies file an enterprise risk report. *See* NAIC Model #440, Insurance Holding Company System Regulatory Act § 4L. Second, states can require large and medium size insurers to file an Own Risk Solvency Assessment. *See* NAIC Model #505, Risk Management and Own Risk and Solvency Assessment Model Act. But in neither case do state insurance regulators have any enforcement authority over the parent itself. For these reasons, insurance subsidiaries must rely on the kindness of their parent companies and affiliates to obtain information about transactions and exposures through the group. *See id.*
[18] NAIC, Model #440, Insurance Holding Company System Regulatory Act § 11.
[19] See NAIC, Model #440, Insurance Holding Company System Regulatory Act § 6(a).

Second, many state insurance regulators lack the expertise, budget, and staff to effectively conduct group-wide supervision of complex insurance groups.[20] Here too, states vary substantially in their capacities. Whereas states like New York employ hundreds of financial examiners and analysts, other states have less than a dozen of these employees. Even New Jersey – which is the lead group regulator for one of the largest and most complicated domestic insurance groups – employs fewer than fifty such financial supervisors.[21]

Finally, state actors' local political accountability also limits their incentives to effectively regulate insurers at the group level. The core problem is that state insurance regulators are either directly or indirectly politically accountable only to the constituents in their jurisdictions. But the benefits of regulating across a large insurance conglomerate with far-flung cross-border operations are felt almost entirely outside of the boundaries of any individual state.

In light of these considerations, it is hardly surprising that both international and domestic assessments of U.S. insurance regulation have repeatedly expressed concern about state insurance regulators' group supervision. For instance, a peer review of the U.S. state-based system of insurance regulation by the Financial Stability Board concluded "that while the state-based regulatory system was effective in assuring policyholder protection and the soundness of individual insurance companies, it lacked a systemic focus and the capacity to exercise group-wide oversight."[22] Similarly, a report

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[20] *See* Jeremy Kress, Prudential's Flawed Case for SIFI De-Designation (draft). For one apt comparison of what happens when under-resourced and outmatched regulators are asked to supervise large and complex financial conglomerates, consider the SEC's disastrous consolidated supervision program over large investment banks. *See* Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 494 (2009).
[21] *See* NAIC, 2016 Insurance Department Resources Report.
[22] Financial Stability Board, Peer Review of the United States 32 (2013).

of the International Monetary Fund noted that international regulatory regimes have increasingly "been supplementing their strong solo company focus with financial and other requirements and more supervisory focus applied at the group level and U.S. supervisors should do the same."[23] And a 2013 report of the Federal Insurance Office emphasized the "shortcomings of solo entity supervision" by state insurance departments.[24]

(3) H.R. 5059 creates the prospect of regulatory arbitrage by financial conglomerates seeking to avoid federal regulation.

One of the primary lessons of the 2008 financial crisis is that effective regulatory supervision is immensely difficult when firms are allowed to select among competing regulators. A central goal of Dodd-Frank was to eliminate this regulatory architecture by dissolving OTS and transferring to the Fed consolidated supervision for all conglomerates that own a federally-insured depository institution. I have substantial concerns that the definition of an ISHLC in H.R. 5059 could undermine these advances by allowing any entity that owns a thrift to restructure itself at limited cost so as to avoid consolidated regulation by the Fed.

Under the Bill's current language, a SLHC could avoid federal oversight by structuring its top-tier holding company as an "insurance underwriting company." This is because the Bill defines an "insurance underwriting company" as a company that is "engaged in the business of insurance," "subject to regulation by a state regulator," and "covered by a State law that is designed to specifically deal with the rehabilitation, liquidation, or insolvency of an insurance company." Pursuant to this definition, a large

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[23] International Monetary Fund, United States: Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of IAIS Insurance Core Principles (2010).
[24] *See* Federal Insurance Office, How to Modernize and Improve the System of Insurance Regulation in the United States (2013).

SLHC would qualify as an ISLHC – and thus escape oversight by the Federal Reserve – simply by convincing a single state insurance regulator to grant its top-tier holding company a license to sell insurance, and then selling a small amount of that coverage.

This is plainly not the intent of H.R. 5059. The problem can likely be avoided by eliminating from the definition of an ISLHC a "top tier savings and loan holding company that is an insurance underwriting company," unless it also meets the quantitative test contained in K(2). Alternatively, the problem could be avoided by only including within the definition of an ISLHC a "top tier savings and loan holding company" that was an insurance underwriting company at the time of enactment, thus paralleling the drafting technique in provision K(3).

Consider a second example of how the Bill could induce damaging regulatory arbitrage. The Bill apparently recognizes the risk that an ISLHC – freed from supervision by the Fed or any other federal actor – could use a non-insurer affiliate to engage in large and risky financial transactions. This, of course, is exactly what AIG did when it issued massive amounts of Credit Default Swaps out of its Financial Products entity. To address this risk, H.R. 5059 preserves the Federal Reserve's authority to investigate and require certain reports of a "material subsidiary" within an ISLHC. Such subsidiaries are defined by reference to various quantitative tests designed to identify large entities within the holding company system. But a motivated ISLHC could avoid this safeguard simply by spreading out financially-risky transactions across numerous relatively small subsidiaries.

Whether or not these specific regulatory arbitrage concerns are addressed in subsequent versions of the Bill, they point to a broader concern I have about H.R. 5059.

By creating a new category of financial institution that is subject to different regulatory rules than other similarly situated institutions, the Bill introduces an inevitable risk of unintended consequences and regulatory arbitrage.

Dodd-Frank was designed to avoid such game-playing by financial institutions. It did so by creating a simple rule: firms that own banks are subject to umbrella supervision by the Federal Reserve. H.R. 5059 undermines this solution, recreating the very same types of deficiencies in regulatory architecture that resulted in the AIG debacle and contributed to the 2008 financial crisis.

(4) The Federal Reserve's current supervision of insurance-focused SLHCs does not interfere with state insurance regulation or impose undue burdens on these financial conglomerates.

H.R. 5059 is motivated by perceived problems that have not been substantiated and that, in any case, are best dealt with by agency, rather than legislative, action. First, the Bill's name – the State Insurance Regulation Preservation Act – wrongly suggests that the Federal Reserve's oversight of insurance-focused SLHCs somehow interferes with traditional state insurance regulation. Yet federal agencies have at least ostensibly exercised such oversight for decades. As described above, even before passage of Dodd-Frank, the OTS was the group supervisor of insurance-focused conglomerates that owned thrifts. Although OTS clearly failed in discharging this responsibility effectively, the relevant point here is that traditional state insurance regulation has persisted for decades alongside federal oversight of holding company systems that include federally-insured banks.

I have seen no evidence that the Federal Reserve's implementation of such long-standing federal supervision interferes with traditional state insurance regulation. To the contrary, the most public indication of the Fed's supervisory approach to these firms clearly and explicitly defers to state insurance regulation with respect to state-licensed insurers. In an Advance Notice of Proposed Rulemaking, the Fed proposed rules that would completely defer to state regulators' capital calculations for state-licensed insurers when it comes to non-systemic, insurance-focused SLHCs. This "building block" approach to consolidated capital rules is consistent with Fed officials' public statements that their supervisory review does not encompass state-licensed insurance companies, and instead focuses on the broader group's corporate governance, risk-management, and internal controls. None of these forms of supervision interfere with traditional state-based insurance regulation.

Although I have less direct knowledge about the compliance costs experienced by insurance-focused SLHCs, I have seen limited evidence that these costs are inappropriate. All supervisory regimes inevitably impose compliance costs on supervised firms. Any company that chooses to acquire a federally-insured depository institution – whether it is engaged in insurance or in selling tractors – must bear those compliance costs. Insurance companies are not in any way special in this respect.

To be sure, it is certainly possible for a supervisory regime to impose excessive and unwarranted compliance costs on firms. But the Federal Reserve's supervisory approach is cognizant of minimizing these costs to the extent possible. For instance, the Federal Reserve explicitly tailors the intensity of its supervision to the size and complexity of the underlying firm. Small and regional SLHCs are subject to much less searching scrutiny than large and complex companies.

To the extent that the intensity of the Federal Reserve's regulation is not well calibrated to the risks and complexity of the holding company systems they oversee, the appropriate remedy is not to eliminate appropriate federal oversight of companies that own federally-insured depository institutions. Instead, it is to adjust the scope and intensity of federal supervision.

ACLI
Financial Security...for Life.

Statement for the Record

House Committee on Financial Services

Subcommittee on Housing & Insurance

Hearing titled "Legislative Review of H.R. 5059, the State Insurance Regulation Preservation Act"

March 7, 2018

The American Council of Life Insurers (ACLI) is pleased to submit this statement expressing support for the State Insurance Regulation Preservation Act, H.R. 5059. ACLI thanks Representatives Keith Rothfus (R-PA) and Joyce Beatty (D-OH) for their leadership on this issue. ACLI also thanks House Financial Services Housing and Insurance Chairman Sean Duffy (R-WI) and Ranking Member Emanuel Cleaver (D-MO) for holding this important hearing.

The ACLI 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 95 percent of industry assets, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States.

ACLI believes any Federal Reserve Board oversight of a savings and loan holding company that contains insurance entities must take into consideration the unique aspects of the business of insurance and the state-based insurance regulatory system. This legislation is flexible, and "right sizes" federal regulation of savings and loan holding companies with insurance entities, without precluding federal regulation in prescribed circumstances.

Thank you for convening this important hearing and for your consideration of the views of ACLI and its member companies.

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NAMIC
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

March 7, 2018

The Honorable Keith Rothfus
United States House of Representative
1205 Longworth House Office Building
Washington, DC 20515

The Honorable Joyce Beatty
United States House of Representatives
133 Cannon House Office Building
Washington, DC 20515

Dear Representatives Rothfus and Beatty,

The National Association of Mutual Insurance Companies writes in strong support of H.R. 5059, the State Insurance Regulation Preservation Act, which provides much-needed clarity to the Federal Reserve Board of Governors on their group-level oversight of savings and loan holding companies primarily engaged in the business of insurance.

One of the authorities the Federal Reserve was given in the Dodd-Frank Wall Street Reform and Consumer Protection Act was that of supervising Systemically Important Financial Institutions, bank holding companies, and savings and loan holding companies – which includes insurance companies which own thrift institutions. While supervision and capital requirements for the consolidated group are now the purview of the Federal Reserve, H.R. 5059 would simply make clear that the examination and oversight of the individual insurance companies within the group would be conducted by state insurance regulators unless failing to meet those capital requirements. This clarity would help to reduce regulatory inefficiency, duplication of effort, and unnecessarily higher compliance costs.

It is very important to ensure that the Federal Reserve Board's oversight complement, rather than supplant, the state-based system of insurance regulation which has worked well in the U.S. for over 150 years. We believe that your legislation strikes the right balance by keeping the day-to-day regulation in the hands of the state insurance departments, while also ensuring that the Board would retain the authority to monitor the organizational structure of insurance savings and loan holding companies, material financial subsidiaries, and compliance with Board-imposed, group-level capital standards. The clarity provided by the bill will lead to more efficient and effective regulation for those companies subject to the Federal Reserve Board's supervision.

NAMIC thanks you both for your leadership in this area and will be strongly urging further consideration and passage of H.R. 5059.

Sincerely,

Jon Bergner

Jonathan Bergner
Assistant Vice President, Federal Affairs
National Association of Mutual Insurance Companies

Opening Statement for Ranking Member Waters

Housing and Insurance Hearing entitled, "Legislative Review of H.R. 5059, the State Insurance Regulation Preservation Act"

Wednesday, March 7, 2018 at 10:00am

Thank you, Mr. Chairman and welcome to all of our witnesses. We are here today to discuss H.R. 5059, the State Insurance Regulation Preservation Act, a bill that seeks to address the current system of supervision for insurers that own depository institutions such as thrifts.

Ever since the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law, these insurers have been subject to consolidated supervision by the Federal Reserve. In drafting Dodd-Frank, Democrats were not only attempting to stabilize the financial system in the wake of the worst financial crisis since the Great Depression, but also make sure our regulators had the tools necessary to prevent the next crisis from ever occurring. Ensuring that there is a strong consolidated supervisor for firms that own deposit-taking banks is critical to that regulatory toolbox.

Of course we don't need to engage in hypotheticals to understand the follies of lax oversight for subsidiaries of an insurance firm because one needs to look no further than the case of AIG, which cost taxpayers $182 billion.

AIG, which was principally an insurer, also conducted other business through its many subsidiaries. Now, as an insurance company, AIG was subject to the state-based system of insurance regulation but as the owner of a thrift, it was also regulated by the now defunct Office of Thrift Supervision. The main problem was that each regulator was siloed and there was no consolidated supervision looking across this vast and diversified firm. In that absence, AIG exploited a huge gap in oversight and that is what informed us when drafting the provisions of law under discussion today.

It is with AIG in mind that I review H.R. 5059, which I believe must be considered very carefully and very thoughtfully. I look forward to hearing from the witnesses today to gain a better understanding of why this legislation is necessary and how it can be improved to ensure that we are not opening the door for the next AIG.

Thank you, and I yield back.

Daniel Schwarcz's Answers to Questions for the Record for HI Legislative Hearing entitled,
Legislative Review of HR 5059, the State Insurance Regulation Preservation Act
March 7, 2018

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1. H.R. 5059 provides specific exemptions for a non-material subsidiary. What is your understanding of the limits of that exemption? For example, could there be an infinite number of non-materials subsidiaries that are each exempt from supervision but taken together could pose a risk to the holding company? In your opinion, when is a subsidiary material? Should that ever include off-balance sheet activities, particularly at the levels seen in this bill of $5 billion?

As I note in my written testimony, a motivated ISLHC could avoid owning a "material subsidiary" simply by spreading out financially-risky transactions across numerous relatively small subsidiaries. Moreover, I am not convinced that the definition of the term "material" in the statute accurately captures what it ought to: the prospect that a subsidiary could pose a "material" risk to the federally insured depository institution within the ISLHC or to the broader enterprise. Attempting to define this risk through relatively arbitrary quantitative thresholds, as H.R. 5059 currently does, seems to be an inherently impossible task. This is precisely why consolidated regulation involves a combination of quantitative and qualitative factors to assess the risks posed by individual subsidiaries to the insured depository institution and larger holding company system.

2. H.R. 5059 defines an insurance savings and loan holding company as one that has a top-tier savings and loan holding company that is an insurance underwriting company, *or* a savings and loan holding company that held 75 percent or more of its total consolidated assets in an insurance underwriting company, *or* be registered as a savings and loan holding company before July 21, 2010 and be a New York not-for-profit corporation. This means that a company only needs to qualify for one of the three definitions created in this bill to be eligible for relief. Is that your reading of the bill as well? If this bill were enacted, what would prevent a company from simply restructuring to game the system and obtain the relief provided for in this bill? Even if the bill were modified so that only companies that meet the definition now would be eligible, is that really good public policy? If we agree that this legislation is necessary now then why shouldn't future companies be eligible as well?

As I emphasized both in my written and oral testimony, I do indeed agree with this interpretation of the bill. Moreover, I am indeed very worried that the Bill would create *substantial opportunities for regulatory arbitrage, by allowing large financial conglomerates to escape consolidated regulation by the Federal reserve simply by having an insurance company become their top-tier holding company. Although I proposed in my written testimony that one option for fixing this problem might indeed be to limit the Bill's applicability to firms that currently meet the definition of an ISLHC, I agree with the concern that this is a somewhat arbitrary solution to the underlying problem. Indeed, it would potentially create an unbalanced competitive landscape, by benefitting incumbents at the expense of new or emerging firms.*

3. Our state-based system of insurance regulation is often credited with its policyholder-centric focus. But when we discuss financial stability, isn't a narrow albeit well-intentioned focus on policyholder protection missing the point? In fact, the Federal Reserve is explicitly tasked with reducing risks to financial stability. What are the possible negative consequences of effectively removing the Fed as the consolidated supervisor for insurance savings and loan holding companies as this bill would do?

As I have emphasized in prior written testimony to the Committee – particularly in my testimony before the Subcommittee on Housing and Insurance regarding "The Federal Government's Role in the Insurance Industry" on October 24, 2017—I absolutely agree that the state system of insurance regulation is focused predominantly on policyholder protection rather than promoting financial stability. Moreover, I continue to believe that there are structural reasons why states simply are not the appropriate repository of a regulatory mission that focuses on promoting financial stability. Although H.R. 5059 applies only to insurance-focused firms that are regulated by the Fed because they own a depository institution, rather than those-insurance focused firms that are regulated by the Fed because they have been deemed systemically significant, I still think that the larger point about the limited goals of state insurance regulation is important. The reason that firms which own federally insured depository institutions are regulated by the Fed is because there are unique risks that come along with owning a bank. Firms that own a bank may exploit federal deposit insurance by causing those banks to enter into transactions that benefit their holding company. Meanwhile, firms that own banks may end up undermining those banks' financial strength by operating as a source of weakness, rather than strength, for those institutions. Just as states do not focus on financial stability, they also do not focus on protecting the federal insurance depository fund. This is why federal regulation in this arena remains essential.

4. The Dodd-Frank Act tasked the Federal Reserve with serving as the consolidated supervisor of insurance companies that own depository institutions. In this role, how does the Federal Reserve's view of the companies it supervises differ from that of the states' view? Why is that distinction important?

State insurance regulation is focused almost exclusively on individual operating insurance companies. Although state regulators have been developing new approaches to extend their regulatory scrutiny to the holding company level, these techniques and capabilities are both new and untested. By contrast, regulation by the Fed is focused exclusively on the larger financial conglomerate. This is an area of expertise that the Fed has developed for many decades, and is a fundamentally different type of supervisory oversight than occurs at the individual legal entity level. Reflecting this distinction, the Fed does not directly supervise any of the insurance companies within the holding company system that are regulated by the states. Instead, the Fed evaluates issues that cross-cut the larger financial conglomerate, such as whether it has appropriate risk management and corporate governance strategies in place.

5. To the extent that the Federal Reserve can further tailor its supervision of insurance savings and loan holding companies in a responsible manner, do you have suggestions for how to more narrowly focus those efforts? Do you agree that this would be a better approach than the approach in H.R. 5059?

I believe that the Fed should continue to work with state regulators in understanding the scope of the issues that are already covered by those regulators in documents like the Own Risk Solvency Assessment (ORSA). I very much agree that continuing to encourage the Fed to work with state insurance regulators is a much better approach to appropriately reducing the regulatory burden on small and well run ISHLCs than the approach reflected in H.R. 5059.

6. AIG famously collapsed and nearly brought down our economy. The exemptions allowed for under this bill are eerily close to many of the risky activities that allowed for the failure of AIG such as the lack of oversight over off-balance sheet activities and the lack of a consolidated supervisor monitoring the entire financial firm for financial stability and safety and soundness. What are your thoughts? Do you have thoughts on how the bill could be improved to ensure that there is an entity with tools to constantly monitor for early warning signs of the next AIG?

AIG very clearly exposed the limits of state insurance regulation when it comes to the consolidated oversight of large financial conglomerates. AIG's failure in 2008 was just as much a failure of the firm's insurance operations as its derivatives business. A major cause of AIG's collapse was the company's ill-fated securities lending program, under which it lent out the assets of its insurers to large financial institutions in exchange for cash collateral, which it then invested in mortgage backed securities. These securities lending contracts were very short-term, thus allowing spooked counterparties to quickly demand a return of their cash collateral. Despite the risks that these operations posed to AIG, state insurance regulators had not identified these operations as a problem until mid-2007. State insurance regulators failed to *diagnose these problems with AIG's securities lending program any earlier because the program was operated by non-insurer affiliates of the company. As a result, no individual insurance regulator took primary responsibility for carefully scrutinizing that program. Just as importantly, state insurance regulators' focus on individual insurance entities also caused them to miss the key fact that the risks associated with AIG's securities lending program were the exact same risks being taken by the company's financial products subsidiary.*

The Bill only indirectly implicates these issues, because it does not purport to impact the Fed's regulation of nonbank firms that are deemed systemically significant by the Financial Stability Oversight Council. But one major way that the next AIG might arise is through a nonbank financial firm's exploitation of the credit-benefits associated with owning a federally-insured depository institution. Ownership of such an institution can allow a non-bank to substantially increase its borrowing, and thus its capacity to pose risks to the larger financial system.

7. The bill sets a fairly high threshold for off-balance activities that could still leave a holding company with several supposedly non-material subsidiaries that would escape federal supervision. Is there any reason that these firms, particularly the smaller-sized and regionally-focused firms would need or want off-balance sheet activities at $5 billion when the consolidated assets of many of the firms that would qualify as ISLHCs are far less? Can you please describe the types of off-balance sheet activities your firms might engage in? Do you feel a $5 billion threshold makes sense for firms of all sizes and structures?

I believe that the primary off-balance sheet activities that a material subsidiary is likely to engage in include derivatives operations and other types of contingent financial guarantees. As indicated above, I do not believe that any arbitrary quantitative definition can properly identify the types of off-balance sheet activities within a subsidiary that are likely to place a holding company or its federally-insured depository institution at risk.

(8) The definition of "material subsidiary" in the bill seems to direct regulators to tailor their examinations to the business of insurance even if the subsidiary is not an insurance firm. Is this a drafting oversight or something you feel is needed for the insurance industry? Please explain.

This does indeed seem like a drafting error to me. Financial firms should be regulated on the basis of the activities they engage in, rather than the firms with which they are affiliated.