

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Insurance, Housing and
Community Opportunity
Committee on Financial Services
United States House of Representatives

Regarding:

Insurance Oversight and Legislative Proposals

November 16, 2011

Joseph Torti, III
Deputy Director and Superintendent of Insurance and Banking
Rhode Island Department of Business Regulation

Introduction

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today. My name is Joseph Torti, and I am Deputy Director and Superintendent of Insurance and Banking for the State of Rhode Island. I am also the Chair of the National Association of Insurance Commissioners (NAIC)'s Financial Condition (E) Committee and I present this testimony on behalf of the NAIC. Through the NAIC and its committees, state insurance regulators establish standards and best practices, conduct peer reviews, and coordinate their regulatory oversight. The NAIC's members working together with the central resources of the NAIC, form the national system of state-based insurance regulation in the United States.

Specifically, I am here to report on the NAIC's engagement with the federal financial agencies to ensure that the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act follows congressional intent and appropriately recognizes the uniqueness of the insurance business model and the strength of the national state-based insurance regulatory system.

To be clear, the NAIC has no position on the Dodd-Frank Act or any current legislative proposals to modify it. The NAIC does, however, strongly believe that the implementation of Dodd-Frank by the federal financial agencies or any legislative efforts to amend it should be consistent with Dodd-Frank's recognition of the uniqueness of the insurer business model and the strength of the national state-based system of insurance regulation.

My testimony today will cover three areas: 1) the characteristics of insurance products that make them different from banking and other financial products, 2) an overview of key aspects of the insurance regulatory system, which ensures the protection of insurance consumers, and 3) the efforts of the NAIC in working with federal financial agencies as they implement provisions of Dodd-Frank that could impact the insurance sector.

The Uniqueness of the Insurance Business Model

Insurance products are fundamentally different from banking and securities products. Bank products involve money deposited by customers and are subject to withdrawal on demand, which the bank is liable for at any time. Insurance policies involve up-front payment in exchange for a

legal promise to pay benefits upon a specified loss-triggering event in the future. The very nature of insurance significantly reduces the potential of a run-on-the-bank scenario for property/casualty, health and most life insurance products. For those limited products sold by insurers that could be subject to some level of run risk, mitigating factors exist such as policy loan limitations, surrender/withdrawal penalties, and additional taxes. Additionally, insurers typically maintain a diverse product mix so only a portion of the company's products would be subject to the already reduced level of run risk.

Importantly, insurance products unlike other financial products, do not transform short term liabilities into longer term assets. Insurance has short tail liabilities in many of the property/casualty and health product lines, and the assets held are similarly short term. Insurance has longer tail liabilities in life and annuity product lines, and these liabilities are matched against similarly longer term assets. This is a critical distinction from banking and other financial products. The reason many other financial firms suffered during the financial crisis was that the duration of their assets and liabilities were not matched in a way that enabled them to fund their liabilities when they came due.

National State-Based System of Insurance Regulation

The current, comprehensive solvency regulatory framework of insurance regulation has been in place since the 1990s and continues to evolve as regulators respond to emerging issues, new products and changes in the financial landscape. The strength of this system was evident during the financial crisis. For example, in 2009, 140 banks failed, but only 18 insurers did. The system's fundamental tenet is to protect policyholders by ensuring the solvency of the insurer and its ability to pay insurance claims. To fulfill this mission, insurers are subject to stringent laws and regulations and insurance regulators have broad authorities to examine all licensed insurers to identify and address issues before they become a threat to insurer solvency. Though insurers are subject to a broad array of regulatory requirements, I will focus on three key areas: 1) the detailed reporting and disclosure requirements, 2) the risk-based capital system, and 3) the state-based receivership to resolve troubled insurers.

Reporting and Disclosure Requirements

The foundation of the national state-based system of insurance regulation's solvency framework is the detailed and transparent insurer reporting and disclosure requirements. Insurers are required to prepare comprehensive financial statements using the NAIC's Statutory Accounting Principles (SAP). SAP utilizes the framework established by Generally Accepted Accounting Principles (GAAP), but unlike GAAP which is primarily designed to provide key information to investors of public companies, SAP is specifically designed to assist regulators in monitoring the solvency of an insurer. While GAAP stresses measurement of earnings of a business from period to period, SAP measures the ability to pay claims in the future. GAAP also recognizes certain assets that SAP treats as "non-admitted" assets or are immediately expensed because they cannot be used to pay the claims of policyholders. However, even though "non-admitted" assets are not included in a SAP statement as total assets and capital, they are still reported on the annual statements filed with the NAIC and available for regulatory review.

Financial statements are filed with NAIC on a quarterly and annual basis and include a balance sheet, an income statement, and numerous required schedules and exhibits of additional detailed information. For example, insurers are required to report on Schedule D all the long-term bond, preferred stock and common stock investments that they own and have acquired or disposed of in the current reporting period. Schedule DB requires each life insurer to report each individual derivatives position held, by type; whether that position is used for hedging purposes; and identification of the position being hedged. Schedule DL requires reporting on securities lending programs including the detail listing of collateral received by the lender, reinvested collateral held, and the ability to match the fair market value of the reinvested cash collateral to the value of the cash to be returned. The NAIC serves as the central repository for this data, including running automated prioritization indicators and sophisticated analysis techniques enabling regulators around the country to have access to national-level data while reducing the redundancy of reproducing this resource in every state. This centralized data and analysis capability has been cited by the IMF as world leading.

Insurance regulators utilize the financial statements and other information as part of their continuous, intensive financial analysis to identify issues that could impact solvency. On an ongoing basis, insurance regulators assess business plans, material transactions, and any reputational or contagion risk posed by such transactions to determine whether to approve, deny, or require additional solvency protections. They analyze impacts of major economic and insurance events through the use of special data requests and stress testing. As part of our solvency system's "Windows and Walls" approach to group supervision, insurers are required to report on any reputational or other contagion risks posed by non-insurance affiliates, the "windows" into the rest of the group. At least every quarter, regulators assess a company's reserve adequacy, leverage, liquidity, surplus, asset quality, investment concentration, or other trends reflected in the filings. Every 3-5 years, regulators engage in full scope on-site examinations. Such exams are risk-focused and are used as a means of validating that the insurer's systems are performing as claimed in their financial statements and regulatory filings.

In addition to this comprehensive analysis, as part of our coordinated national system of state based regulation, the NAIC facilitates the state accreditation program. Accredited insurance departments are required to undergo a comprehensive review by an independent review team every five years, as well as an interim review annually, to ensure the departments continue to meet baseline financial solvency oversight standards. The accreditation standards require state insurance departments to have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, as well as the necessary resources to implement and enforce that authority. Currently, all 50 states and the District of Columbia are accredited.

NAIC compiles the information contained in the comprehensive financial statements to advise insurance regulators of trends in the insurance industry and the impact of exogenous events. For example, the NAIC's Capital Markets Bureau publishes a weekly special report, available on the NAIC's website, that provides industry analysis on a variety of topics that range from insurer use of derivatives, the impact of the low interest rate environment on insurance companies, and insurer investment exposures to Europe. These "macro prudential analyses" conducted by NAIC staff help NAIC members fulfill their regulatory mission by providing important information on how external events in the insurance or other financial markets could impact insurers.

Risk-Based Capital (RBC) Framework

The information provided by financial statements, which is audited by an independent accountant, is also used in the system's risk-based capital framework. This framework requires an insurer to hold at least a minimum amount of capital based on analysis of risks on the insurer's balance sheet. This framework is comprised of a RBC calculation as well as statutory authority for successive levels of regulatory intervention based upon risks assessed in the formula compared to the insurer's capital amount. The formula applies factors to audited annual statement amounts for assets, premiums, claims, expenses, and reserves, and such factors increase for items with greater underlying risk. The RBC formula provides a minimum capital and surplus to support insurer risks such as: asset risk, specifically the risk of default or fluctuation in fair value of investments; insurance risk or the risk of inadequacy of premiums and reserves; and interest rate, credit, or other market risk. A separate RBC formula is used for the life, fraternal, property and casualty, and health industries that reflect the unique investment, underwriting, and other risks to the sector.

Insurance Company Receivership

In the event of the insolvency of an affiliate of an insurer, regulators have the authority to "ring-fence" the insurance company, thereby preventing the affiliate from endangering the solvency of the insurer and protecting policyholders. These are the "walls" in the "Windows and Walls" approach.

In the unlikely event that an insurer becomes troubled, state insurance receivership laws provide authorities for regulators to attempt to prevent insurer insolvencies or to minimize losses and provide protection to policyholders and other claimants in the event of insolvency. Under state receivership laws, regulators dealing with a troubled company have a number of options. They can seek mergers with healthier companies, reinsurance arrangements, non-renewal of part or an insurer's entire book of business, or place the insurer in "run-off mode" where no new business is written, but claims continue to be paid. In 2004, we utilized our broad receivership authority in Rhode Island to place a troubled insurer into rehabilitation, preventing its insolvency while ensuring full payment to policyholders and claimants. We were also able to restructure the insurer making it possible to find a group of highly experienced insurance executives to purchase the company and continue writing personal lines property & casualty insurance in Rhode Island

and several other northeast states. Today, the company continues to pay all claims, provide significant employment opportunities for our residents and is on track to write \$100 million in premiums for the year.

If an insurer does become insolvent, the state receivership laws give policyholders priority over most claimants. In cases where the assets of an insurer are insufficient to pay policyholder claims, the states have guaranty funds to serve as a backstop and protect policyholders of most lines of life and property and casualty insurance. Similar to FDIC backing for bank depositors, guaranty funds cover an insured's financial obligation to policyholders, annuitants, beneficiaries, and third party claimant's up to statutory limits. Together, the broad authorities provided to state insurance regulators under the state receivership laws and the guaranty fund backstop ensure that policyholders are protected and insurance companies are resolved in an orderly manner.

Federal/State Regulator Cooperation in Implementing Dodd-Frank

At its core, Dodd-Frank acknowledges the differences between insurance and other financial products, and the stringent regulation of insurers by state regulators. While not directly focused on the business of insurance, authorities either created or amended by Dodd-Frank Act do impact the insurance sector. Such authorities include the Federal Reserve's regulation of designated non-bank financial institutions, bank holding companies or thrift holding companies that may have insurers as affiliates; the authorities for federal financial agencies to plan for and resolve an orderly liquidation of a systemically risky firm; or the authorities granted to certain agencies to collect information for the purposes of monitoring the financial system or the insurance sector more specifically.

The NAIC works closely with the federal financial agencies, and there is a mutual recognition that the NAIC and its members are a valuable partner and resource to the federal financial agencies. We exchange data and other information, provide trainings to the federal agencies on various insurance regulatory topics, and participate in federal agency seminars and initiatives including those relating to data access and analysis. Beyond these ongoing regulatory dialogues, the NAIC is actively engaged with the federal financial regulators on a variety of issues relating to implementation of the Dodd Frank Act, but I will focus on 6 main areas: 1) the Financial Stability Oversight Council (FSOC); 2) the Federal Deposit Insurance Corporation's (FDIC)

implementation of Title II orderly liquidation authorities; 3) the Federal Reserve's new authorities to oversee FSOC designated non-bank financial institutions and thrift holding companies; 4) derivatives regulation; 5) the implementation of the Volcker Rule; and 6) the ongoing activities of the Federal Insurance Office (FIO).

Financial Stability Oversight Council

State insurance regulators are represented on FSOC through John Huff, the Missouri Director of Insurance, Financial Institutions, and Professional Registration. As you know, FSOC has the authority to designate non-bank financial institutions, potentially including insurance companies, for heightened supervision by the Federal Reserve. Through Director Huff, the NAIC has been educating FSOC members that traditional insurance activities do not pose systemic risk and providing extensive data and analysis to illustrate this reality. That said, we also recognize that unregulated affiliates or other large scale non-traditional insurance activities could potentially pose such risks and might create a basis for such designation.

The FSOC recently released additional guidance to the public regarding the process that it intends to follow in evaluating and eventually designating non-bank financial institutions for enhanced supervision by the Federal Reserve. Insurance regulator participation in the non-bank designations process is mandated by statute and we were heartened to see a commitment by FSOC to involve regulators of any insurance companies under consideration early in the process. This ensures the Council will benefit from our expertise and knowledge of any insurance company that may be under consideration. My fellow regulators and I are in the process of reviewing this guidance and will provide our comments to our FSOC representative, Director Huff. We strongly encourage insurance sector participants to review the guidance themselves and provide comments to FSOC to further inform the process.

We are also pleased that FSOC now has its full complement of insurance expertise with the participation of Director Huff; the Federal Insurance Office (FIO) Director, and former Illinois Insurance Commissioner Michael McRaith; and former Kentucky Insurance Commissioner Roy Woodall as the independent insurance expert. We continue to encourage the FSOC to enable Director Huff to consult with his fellow regulators in other aspects of FSOC's work that could impact insurance. To date, Director Huff remains limited in the discussions he can have with

fellow state regulators regarding FSOC deliberations, including discussion of systemic risk and the review of resolution plans, even though insurance companies are resolved pursuant to state law. Despite the good working relationships we have with the federal financial agencies in other contexts and the great faith we have in Director Huff, his inability to consult with us regarding confidential issues that impact the insurance sector remains of great concern to those of us that have the responsibility of regulating insurance companies.

Orderly Resolution

The NAIC has been engaged in the implementation of new orderly resolution authorities under Title II. The NAIC's Dodd-Frank Receivership Implementation Working Group is composed of insurance receivership regulatory experts and is charged with examining the impact this new regime may have on existing state insurance receivership processes. Recently, the NAIC adopted a new chapter in its NAIC Receivers' Handbook, "Procedures for Prompt Initiation of State Receivership under Dodd-Frank." This addition establishes procedures at the state level to ensure the state receivership mechanism will respond effectively to a receivership arising from a systemic failure.

Over the past year, members of this group and others have been in active discussions with the FDIC regarding other Title II implementation issues that could affect insurance, and have reviewed and responded to specific rules proposed by the agency. We have commented on proposals regarding the circumstances in which the FDIC could exercise its authorities to take a lien on insurance company assets. Regulators have requested that the FDIC allow for the resolution of any mutual insurance holding companies pursuant to state insurance receivership laws, as the statute is unclear in this regard. Both of these comment letters are part of the FDIC's administrative record and we are pleased to provide copies of those letters for this hearing's record (Appendices A and B). While we hope there is never an occasion where the FDIC has to exercise its authorities on a company with insurance operations, the NAIC's solid working relationship with the FDIC will be critical to ensuring that policyholders are protected during such an event.

Supervision of Thrift Holding Companies and Non-Bank Financial Institutions

We also have a strong relationship with the Federal Reserve Board and the Federal Reserve Banks. Even before the passage of Dodd-Frank, the NAIC was in regular contact with the Federal Reserve to discuss items of mutual concern and to share information. That relationship has grown even closer and more important since the passage of Dodd-Frank as the Federal Reserve now has additional regulatory authorities that could impact insurers. An example of this authority is the transfer of the regulation of thrift holding companies from the now defunct Office of Thrift Supervision to the Federal Reserve and establishing the Federal Reserve as the consolidated supervisor of systemically risky non-bank financial companies designated by FSOC. Insurance regulators are meeting with Federal Reserve representatives to exchange information, discuss how we will work together in the regulation of such entities, and provide trainings on insurance regulatory topics and insurance data analysis. The NAIC very much values the relationship with the Federal Reserve Board and the Federal Reserve Banks.

Derivatives

The NAIC has been working closely with the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) by providing them technical assistance and actively responding to rules they have proposed to implement their new authorities to regulate the over-the-counter derivatives market under Title VII of Dodd-Frank. An important proposed rule involves the additional definitions of swaps and security-based swaps. Under the definition contained in Dodd-Frank, these items could erroneously include certain regulated insurance products, and the NAIC has sought clarification from the SEC and CFTC to ensure these definitions do not include certain insurance products sold by regulated insurance companies. The proposed rules by the SEC and CFTC confirm our view, though we believe that certain changes still need to be made to clarify that all regulated insurance products are appropriately excluded. We recently provided comment to the SEC and CFTC (Appendix C) and continue to work with them as they finalize the rule.

The “Volcker Rule”

The NAIC is monitoring the federal financial regulatory agencies’ implementation of the Volcker Rule. The Volcker Rule prohibits insured depository institutions and their affiliates from engaging in proprietary trading, and also mandating additional capital requirements and

quantitative limits for designated non-bank financial companies that engage in such activities. Dodd-Frank provided that the implementation of the Volcker Rule should “accommodate the business of insurance.” Recently, the federal financial agencies proposed lengthy regulations implementing the Volcker rule. The NAIC is in the process of reviewing those regulations to determine whether they do in fact appropriately exclude insurer investments from its prohibitions. Once that review is complete, we will determine whether filing a comment with the federal financial agencies is necessary. We encourage insurance sector participants to do the same and provide comments as appropriate.

The Federal Insurance Office

The NAIC continues to engage directly with the FIO as the office takes shape. The NAIC has a long history of cooperation and collaboration with the Treasury Department in issues such as implementation of the Terrorism Risk Insurance program, ensuring a stable financial infrastructure, anti-money laundering, coordinated response to the Financial Stability Board, and response to the World Bank/IMF Financial Sector Assessment Program. We have had a similar experience to date with FIO, and we look forward to continuing that relationship, working with our friend and former colleague, Michael McRaith. Dodd-Frank provides FIO with the authority to collect information on insurance directly from companies; but it is required to get this information from the states and other sources, such as the NAIC, if available. The NAIC has provided all requested data and information and is committed to providing Mr. McRaith any assistance he needs to fulfill his responsibilities. It is worth noting that several NAIC members, including the NAIC’s new Secretary-Treasurer, Montana Commissioner of Securities and Insurance, Monica J. Lindeen will be serving on the FIO’s recently established Federal Advisory Committee on Insurance. The FIO has a critical role to play as the voice of the federal government on international insurance matters, and we are working with FIO to identify those issues most relevant to our sector, from the implementation of the IAIS ComFrame project to equivalence of US insurance regulation under Europe’s Solvency II regime. The NAIC will continue to serve as the voice of insurance regulators on these key issues, but the voice of the US government is essential, so we look forward to partnering with FIO to demonstrate a united front whenever possible on key issues.

Dodd-Frank requires the FIO to issue a report on insurance regulation by January 2012. The report will include legislative recommendations and look at the potential for federal regulation of insurance, among other requirements. We remain strongly opposed to federal regulation of insurance but hope to have constructive and meaningful input into this report to ensure our views are reflected. State insurance regulation has been subject to stringent review at the federal level before including Congressional hearings, to GAO and CRS analysis, to review as part of legislative developments ranging from the Gramm Leach Bliley Act to Sarbanes Oxley and now the Dodd- Frank Act. This type of review is healthy for our system but historically this scrutiny has focused on the obvious challenges inherent to our multi-jurisdictional approach with emphasis on cost and redundancy. Rarely have these issues been balanced against the strengths of our regulatory system's check and balances and peer review that helped the insurance sector weather the financial crisis far better than others. We look forward to meeting directly with FIO to encourage a balanced view as it finalizes its study and we also look forward to reviewing comments submitted by the insurance sector as regulators are continually seeking input to improve our national state-based insurance regulatory system.

Conclusion

Throughout the debate of Dodd-Frank, the NAIC strongly advocated that the unique nature of the insurance business model and the strong national state-based system of insurance regulation be recognized. That work continues today as the federal financial agencies issue rules and engage in other implementation efforts. I greatly appreciate the open and constructive dialogue we have had with Congress and the agencies. I look forward to continuing our work with you and our fellow financial regulators.

Thank you for this opportunity to testify, and I look forward to your questions.

APPENDIX A

November 18, 2010

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th St., N.W.
Washington, D.C. 20429

Re: Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Provisions
of Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Mr. Feldman:

We write on behalf of the National Association of Insurance Commissioners (NAIC) to submit this comment in response to the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act)¹ published in the Federal Register on October 19, 2010. Founded in 1871, the NAIC is the voluntary association of the chief insurance regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. The NAIC serves the needs of state insurance regulators as they protect consumers and maintain the financial stability of the marketplace.

Section 209 of the Act provides the FDIC authority to implement through rulemaking the provisions relating to the Orderly Liquidation of certain systemically important financial companies. However, the FDIC's authority is not without limits.² As with all rulemaking proceedings, any new rules must be consistent with the language of the statute and Congressional intent.

For decades, the state insurance regulatory regime has had an "orderly resolution" process for financially distressed or insolvent state licensed insurance companies. State insurance receivership laws are primarily designed to protect the policyholders of such insurers, and ensure policyholders can continue to have any claims paid. In furtherance of this goal, state receivership laws generally provide that policyholders receive higher payment priority than other unsecured creditors and state insurance regulators are given broad authorities to rehabilitate or liquidate insolvent insurance companies in a manner that protects policyholders and preserves the value of the insurance company for their benefit.

Title II of the Act recognizes this time-tested insurance company resolution regime already in place under state law. It explicitly requires that an insurance company be resolved pursuant to state law as opposed to the procedures set forth in Title II and requires that the FDIC harmonize any new rules involving insurance companies with the state insurance receivership regime already in place.³ The

¹ Pub. L. No. 111-203.

² Id. at § 209.

³ Id. at §§ 203, 209.

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NAIC has reviewed the proposed rules promulgated by the FDIC and has significant concerns that proposed rule 380.6 is inconsistent with the language of the Act and Congressional intent in this regard.

§380.6: Limitation on Liens on Assets of Covered Financial Companies That Are Insurance Companies or Covered Subsidiaries of Insurance Companies.

Under the proposed rule, whenever the FDIC “makes funds available” to a covered financial company that is an insurer, an affiliate of an insurer, or a subsidiary of insurer, the FDIC can take a lien on “some or all” of the assets of such entities to secure repayment when the FDIC in its “sole discretion” determines that 1) taking such lien is necessary for the orderly liquidation of the entity and 2) taking such lien will not unduly impede or delay the liquidation or rehabilitation of the insurance company or recovery by its policyholders.⁴ While we acknowledge, based on the section by section analysis accompanying the proposed rule, that the stated intent of this rule is to “limit” the ability of the FDIC to take liens on the assets of insurance companies or covered affiliates of such companies in order to protect policyholders⁵, this proposed rule does precisely the opposite—it effectively provides the FDIC the unilateral right to impose a lien on the assets of an insurer whenever the FDIC deems it appropriate. This is in clear violation of the explicit language of the Act and Congressional intent.

Application to Insurance Companies

First, the proposed rule as applied to insurance companies would violate the explicit language of the Act. This rule implements authorities provided to the FDIC under Section 204 of the Act. However, that section only applies in circumstances where Title II orderly liquidation procedures are utilized and the FDIC is appointed receiver by a Federal District Court pursuant to Section 202 of the Act. However, insurance companies are not subject to Title II orderly liquidation procedures. In cases involving insurance companies, Section 203(e) applies. That section requires that “. . . the liquidation or rehabilitation of [an] insurance company . . . shall be conducted as provided under applicable State law.” Indeed, even in the unlikely event that the state insurance regulators do not file a receivership petition in state court within 60 days and the FDIC has to utilize its backstop authority provided in Section 203(e)(3), that authority only allows the FDIC to stand in the place of the insurance regulator, file the appropriate action in state court and conduct the receivership pursuant to state law. Under no circumstances would Section 202 apply to the resolution of an insurance company. Therefore, the application of this rule to insurance companies violates the explicit language of the Act and, for this reason, the NAIC requests that the rule be changed so it does not apply to insurance companies.

Even if it could somehow be interpreted that Section 204 applies to resolutions conducted under Section 203(e), the proposed rule would, in circumstances where funds were “made available” to an insurer during the resolution process, allow the FDIC to impose a lien “in its sole discretion.” As explained above, Title II requires that insurance companies be resolved pursuant to state law and that any rules implementing Title II be harmonized with the state laws and regulations governing state insurance receiverships. At bare minimum, state law provides that the imposition of such a lien could be voidable by the Court under some circumstances upon petition by the receiver, creditors, or other interested parties.⁶ Under certain state's laws, post-petition liens, transfers of property, and other post-petition obligations can only be incurred by an insurer when authorized by 1) the receiver appointed by the state

⁴ Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. at 64182 (October 19, 2010).

⁵ Id. at 64179.

⁶ See, e.g., Iowa Code § 507C.28 (1992); New York Ins. Law § 7425(c)(1989).

insurance regulators and/or 2) the state court.⁷ In either event, the FDIC would not have "sole discretion" to impose such a lien. In light of the proposed language's clear conflict with the Act and state law, the rule should be amended to state that such liens can only be imposed on an insurance company in consultation with the receiver, and with the approval of the receiver or Court in accordance with the law of the state where the insurance company is domiciled.

Application to Non-Insurance Subsidiaries and Affiliates of Insurers

Second, even as applied to non-insurance subsidiaries and affiliates, the language is potentially inconsistent with the letter of the law requiring harmonization with the state regulatory regime and with Congressional intent. As presently drafted, if funds are made available to a non-insurance subsidiary or affiliate, the FDIC can impose a lien on some or all assets of the company, potentially including assets of an affiliated insurer or, in the case of a parent, any majority ownership interest. We understand the intent of this provision is to allow the FDIC to protect its interest when it injects funds into a non-insurance subsidiary or affiliate it is resolving, but are concerned that such actions may interfere with the regulation or resolution of an insurance company under state law. Typically, state law requires that any material lien or change of control exercised on an insurance company be approved by the insurance regulator. If the intent of this language is to enable, among other scenarios, the FDIC to reach into the affiliated insurance company and exercise a lien on its assets or, alternatively, to exercise a lien on any majority ownership interest in that insurance company without the approval of the state insurance regulators, such an application would be in conflict with state law, and, therefore, inconsistent with Congressional intent in passing this Act.

In passing the Act, Congress intended to preserve the state regulation of insurance and its receivership regime. Section 203 of Title II explicitly preserves the role of the states in resolving insurance companies. Title X specifically excludes the business of insurance from regulation by the newly formed Bureau of Consumer Financial Protection. Title V significantly limits the newly formed Federal Insurance Office's ability to preempt state insurance laws. Importantly, Title II specifically preserves the state law regime for insurance company receiverships and requires the FDIC to harmonize its actions with that regime. To this end, the NAIC respectfully requests that the rule be clarified that the imposition of such liens be limited only to the assets of non-insurance subsidiaries or affiliates and, where the exercise of such a lien could result in a change of control, require the approval of the appropriate state insurance regulator in accordance with state law.

"Making Funds Available"

Third, as presently drafted, the language "making funds available" in the rule could lead to unintended results. We understand the need and desire of the FDIC to ensure that when government funds are actually provided to a covered financial institution, it must, to the best of its ability, ensure the repayment of such funds. As drafted, however, the proposed rule is triggered when the FDIC "makes funds available" to the insurer or affiliate, not when funds are actually provided by the FDIC and used by the company. On its face, the language allows the FDIC to take a lien when it provides a backstop guaranty even though the guaranty is never triggered and the FDIC may never provide a single dollar to the insurer or the affiliate under its terms. This language also allows the FDIC to impose a lien on an insurer upon the mere announcement of a program to provide funds to troubled companies by application along the lines of some of the TARP funding programs administered by the Treasury Department during the financial crisis. The imposition of a lien in such circumstances would be

⁷ See, e.g., Texas Ins. Code Ann. § 443.203 (Vernon 2009).

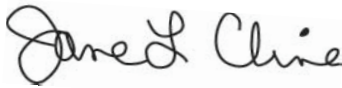
unnecessary and be disruptive to what will likely be an already complex resolution process. For this reason, we respectfully request that the language be changed to ensure that the rule is triggered only in circumstances where funds are actually provided to and used by the insurer.

Liens on Affiliates

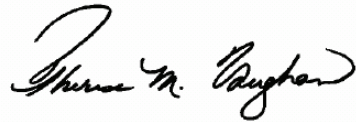
Last, Section 380.6 of the proposed rule refers to FDIC authority to impose liens on affiliates in addition to covered financial companies and covered subsidiaries. Section 204(d) of the Dodd-Frank Act does not reference any authorities provided to the FDIC to impose liens on affiliates. We, therefore, respectfully request that the references to affiliates in Section 380.6 be removed.

In conclusion, we appreciate the opportunity to comment to these proposed rules. Should you wish to discuss this response or any other matter relating to the NAIC's views on the rulemaking process, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471-3980, Moira Campion McConaghy, Government Relations Manager, at (202) 649-4997, or Mark Sagat, Government Relations Analyst and Counsel, at (202) 471-3987.

Sincerely,



Jane L. Cline, Commissioner
West Virginia Insurance Department
NAIC President



Therese M. Vaughan, Ph.D.
NAIC Chief Executive Officer

APPENDIX B

January 18, 2011

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th St., N.W.
Washington, D.C. 20429

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Dear Mr. Feldman:

We write on behalf of the National Association of Insurance Commissioners (NAIC) to submit this comment in response to the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act)¹, which was published in the Federal Register on October 19, 2010 (Notice). Founded in 1871, the NAIC is the voluntary association of the chief insurance regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. The NAIC serves the needs of state insurance regulators as they protect consumers and maintain the financial stability of the marketplace.

The NAIC previously submitted comment to the proposed rule contained in the Notice on November 18, 2010. In that comment, we explained our concerns with proposed rule 380.6 relating to the limitations on liens on assets of covered financial companies that are insurance companies or covered subsidiaries of insurance companies. Specifically, we noted that Title II of the Act recognized the time-tested insurance company resolution process already in place by requiring that an insurance company be resolved pursuant to state law. We also noted that the FDIC must harmonize any new rules involving insurance companies with the state receivership regime already in place.²

As part of the Notice, the FDIC also requested comments identifying specific areas relating to the FDIC's orderly liquidation authority that would benefit from additional rulemaking.³ In this regard, we have identified two specific areas that we believe require additional rulemaking.

¹ Pub. L. No. 111-203.

² Id. at §§ 203, 209.

³ Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. at 64180 (October 19, 2010).

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Consultation with Insurance Regulators

Section 204(c) of the Act requires that the FDIC consult with 1) the primary financial regulatory agencies of covered financial companies for the purpose of ensuring an orderly liquidation of such companies, and 2) the primary financial regulatory agency of any covered financial companies' subsidiaries that are not covered subsidiaries to coordinate on the treatment of such subsidiaries when solvent or the resolution of such subsidiaries when insolvent. As we indicated in our comment of November 18, 2010, the state insurance regulatory regime presently has an orderly resolution process for financially distressed or insolvent state licensed insurance companies. This process is primarily designed to protect the policyholders of such insurers, by safeguarding, marshaling and distributing assets in accordance with payment priorities of each class of claim specified under state law. As a result, state receivership laws are somewhat different than the bankruptcy laws and the rules used to resolve failing banks.

Because of the unique nature of the state insurance regulatory system, we believe, as the Act requires, that it is critical that the FDIC consult with state insurance regulators of any insurance company involved in or affected by the orderly liquidation of a covered financial company. We respectfully urge the FDIC to put processes in place through rulemaking to ensure prompt and robust coordination with the appropriate regulators. Such an effort should include processes to provide the domestic insurance regulator advance warning if the FDIC, as a part of a resolution of a covered financial company, is considering taking any action with respect to an insurance holding company or a subsidiary of an insurer.

Mutual Insurance Holding Companies

Another area that requires rulemaking is the treatment of mutual insurance holding companies as insurance companies for purposes of Title II of the Act. Under Section 203(e), insurance companies are to be resolved pursuant to state law. Section 201 defines "insurance company" as an entity that is "1) engaged in the business of insurance, 2) subject to regulation by a state insurance regulator, and 3) covered by a state law that is designed specifically to deal with rehabilitation, liquidation, or insolvency of an insurance company."⁴ As holding companies, mutual insurance holding companies do not specifically engage in the "business of insurance", but are nevertheless subject to regulation by state insurance commissioners and state receivership authorities. We are concerned that even though such entities are subject to state receivership laws, the FDIC could interpret Title II to require such entities be resolved pursuant to the new authorities granted the FDIC rather than pursuant to state law as is required for all other insurance companies. The legislative history of the Act is clear that such mutual insurance holding companies should be treated as insurance companies and be resolved pursuant to state laws and regulations.⁵ We therefore urge the FDIC to confirm Congressional intent through rulemaking and clarify that mutual insurance holding companies are resolved pursuant to state law.

⁴ Pub. L. No. 111-203 at § 201.

⁵ See, 156 Cong. Rec. S5903 (daily edition July 15, 2010)(statements of Sen. Nelson and Sen. Dodd); 156 Cong. Rec. H5216 (daily edition June 30, 2010)(statements of Rep. Frank and Rep. Carson).

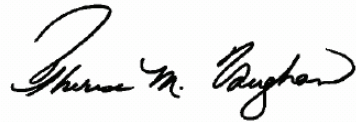
Conclusion

In conclusion, we would appreciate the opportunity to comment on these issues with you further. We look forward to reviewing any other proposed rules relating to these issues and providing comments as appropriate. Should you have any questions regarding this response or any other matter relating to the NAIC's views on the rulemaking process, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471-3980, Moira Campion McConaghy, Government Relations Manager, at (202) 649-4997, or Mark Sagat, Government Relations Analyst and Counsel, at (202) 471-3987.

Sincerely,



Susan E. Voss, Commissioner
Iowa Insurance Division
NAIC President



Therese M. Vaughan, Ph.D.
NAIC Chief Executive Officer

APPENDIX C

July 22, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F St., NE
Washington, D.C. 20549

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: S7-16-11: Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.

Dear Ms. Murphy and Mr. Stawick:

We write on behalf of the National Association of Insurance Commissioners (NAIC) regarding the Securities and Exchange Commission and Commodity Futures Trading Commission proposed rule to further define the terms “swap” and “security-based swap” contained in Title VII of the Dodd-Frank Wall Street and Consumer Protection Act (the Act)¹ and related implementing regulations. Founded in 1871, the NAIC is the voluntary association of the chief insurance regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. The NAIC serves the needs of state insurance regulators as they protect consumers and maintain the financial stability of the marketplace. The NAIC respectfully submits the following comment to the proposed rule published in the May 23, 2011 issue of the Federal Register as well as on the Commissions’ websites.

Insurance Contract Exclusion

We are in agreement with the Commissions’ proposal to exclude insurance contracts from the definitions of “swap” and “security-based swap.” As we indicated in our letter of September 20, 2010, we believe that Congress did not intend for these definitions to cover insurance contracts. We do have some additional comments and concerns regarding the Commissions’ general approach to implementing such a standard by establishing both a per se exclusion for certain defined types of insurance products and a legal test to distinguish insurance from swaps and security-based swaps based on the nature of the product and its regulation.

¹ Pub. L. No. 111-203.

List of Specific Insurance Products

While we agree with the identification of certain insurance products that in the Commissions' view are not swaps or security-based swaps, we strongly urge you to include this list in the rule text itself and not just the preamble to the rule. Such inclusion is critical to create the necessary legal certainty that such products will in fact not be treated as swaps and security-based swaps by the Commissions. In addition, there are certain products, such as mortgage guaranty, accident, and disability insurance that are not on the Commissions' current list of specifically identified insurance products. These items are traditional insurance products sold by regulated insurance companies and should also not be considered swaps or security-based swaps. **Therefore, we respectfully request that mortgage guaranty, accident, and disability insurance be added to the list of excluded products, and that the entire product list be included in the actual rule text.**

In addition, there are other state-regulated products such as service contracts that are not on this enumerated list, and may not necessarily meet the legal test established by the Commissions' rule. We hope to continue to work with you to determine whether such products should be regulated as swaps, security-based swaps or insurance.

Test for Identification of Insurance Contracts

Under the proposed rule, an insurance contract is excluded if it meets the requirements set forth by the Commissions to identify an insurance contract ("Insurance Product Test") and is provided by an entity organized as an insurance company and subject to supervision by an insurance regulator ("Insurance Company Test").

Insurance Company Test

Of significant concern is that if an insurance contract met the requirements of the Insurance Product Test but failed to meet the Insurance Company Test, it would be possible for a non-insurance company to write traditional insurance products and evade the state-based insurance regulatory system designed to protect policyholders. Currently, state insurance regulators have the regulatory authority to prohibit such activities by unlicensed companies and vigilantly pursue wrongdoers. However, since Title VII of the Act provides that swaps shall not be considered insurance and prohibits swaps to be regulated as insurance contracts under the laws of any state,² an insurance product that met the Insurance Contract test but failed the Insurance Company Test would have the unintended consequence of being treated as a swap rather than insurance. Importantly, such a company would not be subject to the type of regulation that has been specifically designed to protect policyholders including stringent solvency, reporting, disclosure, investment limitations, and other important consumer protections. For example, property and casualty insurance offered by an unlicensed company that failed the Insurance Company Test would be treated as a swap rather than insurance and by virtue of the Act, state regulators would be prohibited from using their regulatory authority to prohibit such unlicensed activities.

Furthermore, the Insurance Company Test appears to capture insurance contracts written in foreign countries where the risk is reinsured by domestic reinsurers, yet appears to exclude insurance contracts written domestically where the risk is reinsured by companies located abroad. Such an approach would inevitably create an unlevel playing field as between domestic and foreign reinsurers.

²Pub. L. No. 111-203. §722(a).

For these reasons, we strongly urge you to amend ii(A) of the proposed rule to read as follows:

“By a person or entity that is subject to the insurance laws of any State, the United States, or a foreign jurisdiction.”

Insurance Product Test

The Insurance Product Test in the proposed rule generally states that the term “swap” does not include an agreement, contract, or transaction that by its terms or by law, as a condition of performance on the agreement, contract, or transaction:

- (1) requires the beneficiary to have an insurable interest that is the subject of the agreement, contract, or transaction and thereby carry the risk of loss with respect to that interest continuously throughout the duration of the agreement, contract or transaction;
- (2) requires the loss to occur and to be proved, and that any payment or indemnification thereof be limited to the value of the insurable interest; and
- (3) is not traded, separately from the insured interest, on an organized market or over-the-counter.

However, most insurance products would not qualify under this three prong test. Therefore, the proposed new requirements are not effective criteria for determining whether a product is insurance.

With regard to the first prong, most insurance products do not require a person or entity to have an insurable interest continuously throughout the duration of the insurance policy or contract. For example, if a person wishes to procure insurance on the life of another person, then he or she only needs to have an insurable interest at the time that he or she procures the life insurance policy. With regard to insurance covering property damage, in many jurisdictions, a person only needs to have an insurable interest at the time of the loss. Indeed, an insurable interest is not even required for a liability, surety or accident and health insurance policy or contract.

While we recognize that you may be concerned that certain entities could seek to evade the rule by creating swap products that meet a test designed to exclude insurance products, we believe that the additional requirements that the product be sold by a company that is subject to insurance laws and regulation, coupled with the Commissions’ anti-evasion authorities, will prevent such scenarios from taking place.

There are also difficulties with the third prong. The preamble states that with limited exceptions (such as settled life insurance policies), insurance products traditionally have not been either entered into on or subject to the rules of an organized exchange or traded in secondary market transactions. While we recognize that this is the case for most insurance products, a limited number of states including New York, Illinois, and Florida have had insurance exchanges through which reinsurance and excess or surplus line insurance was sold. In addition, the federal health care act requires states or the federal government to establish health benefit insurance exchanges through which insurers will sell health insurance to individuals and small groups. As a result, we do not believe that the test should contain the requirement that such contract should not be traded on an exchange.

In light of these concerns, we believe that a more appropriate test for an insurance contract would be an agreement or contract that by its terms:

- 1) Exists for a specified period of time;**
- 2) Where one party (the "insured") to the contract promises to make one or more payments such as money, goods or services;**
- 3) In exchange for another party's promise to provide a benefit of pecuniary value for the loss, damage, injury, or impairment of an identified interest of the insured as a result of the occurrence of a specified event or contingency outside the parties' control; and**
- 4) Where such payment is related to a loss occurring as a result of the contingency or specified event.**

We believe that such a test along with the portion of your proposed Insurance Company Test as modified above will appropriately capture regulated insurance products.

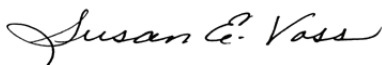
Contracts Based on Price, Rate, or Level of Financial Instrument or Asset

Finally, the Commissions also request comment as to whether they should require that an agreement, a contract, or a transaction not be based on the price, rate, or level of a financial instrument, asset, or interest or any commodity in order to meet the definition of an insurance agreement. We do not believe such a requirement would be appropriate, as it would not meaningfully distinguish swaps and security-based swaps from certain products sold by regulated insurance companies such as variable annuities, indexed annuities, guaranteed investment contracts, financial guaranty insurance, and mortgage guaranty insurance. While swaps and security-based swaps were historically unregulated, products such as those referenced above have been subject to stringent regulatory requirements including policy form filing, financial statement reporting, disclosure, capital, and reserve requirements designed to protect the policyholders. **For these reasons, we believe that the Commissions should not include an additional requirement for an agreement to be treated as insurance that the agreement not be based on the price, rate or level of a financial instrument, asset, or interest or any commodity.**

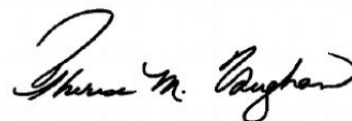
Conclusion

We appreciate the opportunity to comment and look forward to continuing the open and constructive dialogue we have had with the Commissions to date about the rulemaking process. Should you wish to discuss this comment or any other matter relating to the NAIC's views on the rulemaking process, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471-3980, Moira Campion McConaghy, Government Relations Manager, at (202) 649-4997, or Mark Sagat, Government Relations Policy Counsel, at (202) 471-3987.

Sincerely,



Susan E. Voss, Commissioner
Iowa Insurance Division
NAIC President



Therese M. Vaughan, Ph.D.
NAIC Chief Executive Officer