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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) <u>H.R. 5059 violates the fundamental principle that bank owners must be subject to effective consolidated oversight at the federal level.</u>

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) <u>State Insurance Regulators' Group Supervisory Processes are Limited and Untested</u>

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

[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

[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

[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) <u>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.</u>

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.