# TESTIMONY OF MICHAEL MAHAFFEY

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**On Behalf of Nationwide Mutual Insurance Company and the Insurance Coalition**

**Before the United States House of Representatives Financial Services Committee**

**Subcommittee on Housing and Insurance**

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

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

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

## About Nationwide and its Supervisory and Regulatory Environment

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

Nationwide Mutual Insurance Company ("Nationwide Mutual") and its property and casualty insurance subsidiaries primarily underwrite personal automobile, homeowners and commercial insurance products. Nationwide Financial Services, Inc. ("Nationwide Financial"), an indirect subsidiary of Nationwide Mutual, develops and sells a diverse range of products, including individual annuities, private and public sector retirement plans and other investment products

sold to institutions, life insurance and advisory services. In addition, Nationwide Financial provides banking products and services through Nationwide Bank, a federal savings bank and member FDIC.

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

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

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

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

**A Brief History of Federal Reserve Supervision of Insurance SLHCs**

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

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

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

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

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

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

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

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

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

**Duplicative and Inefficient Holding Company Supervision and Regulation of Nationwide**

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

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

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

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

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

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

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

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

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

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

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

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[5] See Supervision and Regulation (SR) 97-24, *Risk-Focused Framework for Supervision of Large Complex Institutions*, October 27, 1997, and the National Association of Insurance Commissioner (NAIC) *Financial Condition Examiners*, Section 2, "Risk-Focused Examination Process".
[6] See Supervision and Regulation (SR) 12-17, *Consolidated Supervision Framework for Large Financial Institutions*, December 17, 2012.
[7] See the NAIC Corporate Governance Annual Disclosure Model Act (#305) and Model Regulation (#306); Risk Management and Own Risk and Solvency Model Act (#505); Annual Financial Reporting Model Regulation (#205); Insurance Holding Company System Model Regulatory Act (#440) and Model Regulation (#450); and the NAIC *Financial Condition Examiners Handbook* and *Financial Analysis Handbook.*
[8] See the NAIC *Financial Condition Examiners Handbook*, Exhibit C "Evaluation of Controls in Information Technology".
[9] See *Federal Financial Institution Examination Council (FFIEC) IT Examination Handbook* and *Cybersecurity Assessment Tool*.

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

**The Need for a Tailored Supervisory Approach**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Conclusion**

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

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