

March 19, 2010

## House Holds Hearing on Insurance Holding Company Supervision

On Thursday, March 18, 2010, the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, chaired by Representative Paul Kanjorski (D-PA), held a hearing to examine the interaction between federal and state regulators regarding oversight of holding companies containing entities conducting insurance activities. The witness list for this hearing was composed of Jon Greenlee, Associate Director, Division of Banking Supervision and Regulation, Federal Reserve Board of Governors; Grovetta Gardineer, Managing Director for Corporate and International Activities, Office of Thrift Supervision (OTS); the Honorable Sean Dilweg, Commissioner, Wisconsin Department of Insurance; and the Honorable Ann Frohman, Director, Nebraska Department of Insurance.

**Testimony from the Federal Reserve.** Associate Director Greenlee's testimony included a description of the scope of the Federal Reserve's supervisory and regulatory authority over bank holding companies (BHCs), financial holding companies (FHCs) and state member banks and provided an overview of the types of insurance activities that may be conducted by banking organizations supervised by the Federal Reserve. Mr. Greenlee noted that the primary purpose of bank supervision and regulation was to ensure that the holding company and its non-bank subsidiaries do not pose a threat to the BHC's insured depository institutions. He noted further that in conducting their supervisory and inspection activities, the Federal Reserve worked closely with the primary supervisor of a BHC's subsidiary depository institutions as well as the functional regulator of any securities broker/dealer or insurance company owned by a BHC. Mr. Greenlee observed that under the current supervisory regime, the Federal Reserve adjusts its supervisory methods and analysis to account for the unique risks and nature of insurance products, the additional risks arising from underwriting of life insurance policies and from underwriting of property and casualty insurance policies, as the case may be, as applicable to individual member banks.

Importantly, however, Mr. Greenlee stated that the current financial crisis has clearly demonstrated that risks to the financial system can arise not only in the banking sector but also from the activities of other financial firms—such as investment banks or insurance companies—that traditionally have not been subject to the type of regulation and consolidated supervision applicable to bank holding companies. According to Mr. Greenlee, to close this important gap in our regulatory structure, legislative action is needed that would subject all systemically important financial institutions to the same framework for consolidated prudential supervision that currently applies to BHCs and FHCs. Such action would prevent financial firms that do not own a bank, but nonetheless pose risks to the overall financial system because of the size, risks, or interconnectedness of their financial activities, from avoiding comprehensive supervisory oversight.

**Testimony from the OTS.** OTS Managing Director Gardineer testified as to the current OTS authority and initiatives to supervise the insurance activities of savings and loan holding companies. Managing Director Gardineer further noted, however, that the regulatory framework governing insurance holding companies should be amended to provide the functional regulator of the largest activity within a diversified financial company (in this case the insurance regulator) the authority to act as the consolidated holding company regulator. In that instance, the core business program of the company would align with the expertise of the holding company regulator. In this context, Managing Director Gardineer believed that the insurance regulator should be at the federal, and not the state, level, if Congress chose to create one. In the absence of a creation of a federal insurance regulator, Managing Director Gardineer testified that at

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a minimum, a federal insurance office should be established with authority over insurance holding companies and non-functionally regulated affiliates.

**Testimony from Insurance Regulators.** Commissioner Dilweg, testifying on behalf of the National Association of Insurance Commissioners (NAIC), broadly described how state regulators assess the financial strength of an insurer. In particular, Commissioner Dilweg focused on the efficacy of the NAIC Financial Analysis Working Group, emphasizing that the NAIC's focus on financial regulation of insurers is a critical component that ensures the most important consumer protection, that of solvency. He noted further that the NAIC created three core solvency surveillance mechanisms—reporting, analysis and examination—to ensure that the obligations to policyholders, claimants, contract holders and other parties are met both today and in the future. Commissioner Dilweg further explained the NAIC Accreditation Program and explained how the Accreditation Program allows for effective solvency regulation while encouraging interstate cooperation and reducing regulatory redundancies.

Finally, Director Frohman described the mechanics of the regulation of insurance holding companies, namely the Insurance Holding Company System Regulatory Act, and described how it allowed for significant supervision of holding company activities, noting, however, that in light of the recent financial crisis, there are lessons learned that could strengthen holding company supervision.

Director Frohman also described the advantages of so-called Supervisory Colleges, which involve the interaction of numerous regulators from across the globe who communicate with respect to a particular issue. The example cited by Director Frohman was that greater in-depth analysis provided by the Supervisory College looking at the operations of Berkshire Hathaway had contributed to everyone's understanding of that entity group.

**Questions from Committee Members.** For the most part, questioning by members of the Subcommittee merely extracted details or additional color on the base testimony of the witnesses. Also noteworthy from the hearing were statements by Representative Scott Garrett (R-NJ) that the federal government's first mission ought to be to do no harm, noting that while there is some need for regulatory modernization, the principal cause for failures was the conduct of the supervisors, rather than failure of the regulations themselves. He also noted his concern with the current regulatory reform proposal championed by Senator Dodd.

Taking a contrary view, however, was Representative Edward Royce (D-CA), who commented that the current status quo of 51 effective regulators results in significant red tape and price control and thus was inconsistent with the Commerce Clause and the intent of the Framers of the U.S. Constitution. As a result, Representative Royce supports a national insurance charter. We note that Representative Royce has co-sponsored legislation in the past that establishes an optional federal charter for insurance companies.

The hearing and the written testimony of the witnesses should be helpful to members of the Subcommittee in assisting their further understanding of current insurance holding company regulation as well as current regulation and supervision of bank holding companies and financial holding companies that have insurance operations.



*If you have any questions regarding this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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