July 19, 2011

Dodd-Frank: One Year Later

A Look Back – and a Look Ahead

NAMIC®
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

An Executive Report from the National Association of Mutual Insurance Companies

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Introduction

July 21, 2011 marks the one-year anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act being signed into law.

The financial crisis that began in the fall of 2008 with the collapse of Bear Stearns and Lehman Brothers, the near-failure of AIG, and worldwide market losses culminated in the United States with the single largest overhaul of financial services regulation since the New Deal. The Democratic-controlled Congress and the Obama Administration were determined to rein in what was perceived to be a financial services industry out of control.

Coming on the heels of the federal government's emergency bailouts of the country's largest banks, the federal support of the collapsing auto industry and the passage of a massively expensive economic stimulus bill, the Dodd-Frank bill was constructed to increase regulation of banks, hedge funds and other financial institutions that were believed to have precipitated the crisis. While property/casualty insurers played no role in creating the economic crisis and remained healthy and solvent throughout the meltdown, this enormous legislative response threatened to drag in every corner of the financial services universe regardless of complicity in creating the problem or ability to weather the storm.

Following two full years of legislative debate – and long hours of hard work advocating and educating on Capitol Hill – NAMIC succeeded in persuading lawmakers to exclude the mutual property/casualty industry from the vast majority of the legislation.

A major source of contention concerned the question of which industry sectors and institutions create "systemic risk" and are therefore "systemically significant," meaning that their failure could cause the entire financial system to collapse. Through NAMIC's efforts, the business and conduct of insurance companies was largely recognized as not creating systemically significant risk and was thus excluded from the new Consumer Financial Protection Bureau and the investment restrictions of the Volcker Rule. Strict limits were also placed on the regulatory power of the new Federal Insurance Office.

NAMIC is applying the same arguments that were successful on Capitol Hill to the various federal agencies responsible for the on-going Dodd-Frank implementation process. NAMIC remains vigilant to ensure that these agencies do not overreach in putting the various sections of the law into place. It was clearly Congress's intent to exclude the property/casualty insurance industry from the majority of Dodd-Frank and prevent it from being improperly placed under federal regulatory jurisdiction – and NAMIC will be there reminding the regulators of this fact.

Dodd-Frank Implementation

Over the course of the past year, the ten federal agencies charged with implementing Dodd-Frank have slowly begun issuing proposed or final regulations that put into effect the hundreds of provisions found in Dodd-Frank. These agencies are responsible for issuing over 500 new rules, conducting 60 new studies and preparing almost 100 new reports to Congress.

The mammoth size of this implementation process requires an organized and coordinated effort on the part of the property/casualty insurance industry to effectively respond. Perhaps most important – given the number and variety of rulemakings happening in the wake of Dodd-Frank – is to ensure that no rulemakings that could impact property/casualty insurers slip through the cracks.

In order to promptly and comprehensively respond to these administrative rulemakings NAMIC formed a Dodd-Frank implementation policy working group. The working group consists of NAMIC lobbyists and policy staff as well as representatives from member companies. The working group reaches beyond industry government affairs representatives and involves input from legal, underwriting, and policy departments. In addition, input from the NAMIC Federal Affairs Committee and outside consultants is a valuable aspect of the working group.

When Dodd-Frank became law one year ago the financial services industry in Washington waited on pins and needles for a potentially overwhelming flood of regulations. However, as months dragged by, rulemakings only dribbled out in small numbers. After time it became apparent that the regulators themselves were uncertain what direction to take in their rulemaking activities. It was also evident that the changing political winds following the 2010 election that gave control of the House to the Republicans were having an impact. Regulators seemed to be holding back on rampant rulemaking in case the funding they required was cut or sections of Dodd-Frank were rolled back.

However, NAMIC believes that the initial trickle of proposed regulations and notices for comment is still just the tip of the iceberg. An increased number of Dodd-Frank implementation activities are anticipated in the coming months as staff positions get filled. There is also a growing belief among opponents to Dodd-Frank on Capitol Hill that the bill cannot be repealed in total.

One area in which to rein in Dodd-Frank is through funding of the regulators' Dodd-Frank activities. By tightening the purse strings some of the more onerous activities can be severely limited. The very week that marks Dodd-Frank's anniversary, the House will consider the Financial Services and General Government Appropriations Act for 2012. This legislation provides annual funding for the Treasury Department and the Securities and Exchange Commission, among others. The bill includes a total of $19.9 billion in funding for the agencies, which is nearly $2 billion – or 9 percent – below last year's level, nearly $6 billion below the President's fiscal year 2012 request, and more than $700 million below the pre-stimulus, pre-bailout levels enacted in 2008. By deliberately underfunding the implementation process, Congress may be subjecting Dodd-Frank to what the bill's co-author Rep. Barney Frank, D-Mass., is calling a "death by a thousand cuts."

NAMIC has successfully worked over the last two years to ensure the mutual property/casualty insurance industry was not swept into the radical reform of Wall Street. This work will continue as implementation goes forward. The creation of the Dodd-Frank implementation policy working group and our responses to the initial round of rulemakings are first steps in a continued vigilance to ensure our industry remains outside the broad scope of this legislation.

Federal Insurance Office

Of concern to NAMIC is the establishment of the first ever federal office to examine the business of insurance.

The Federal Insurance Office (FIO) was created out of the perceived need for insurance expertise at the federal level in the wake of events such as 9/11 and Hurricane Katrina. NAMIC was deeply engaged in debate over creation of such an office for several years – working with policymakers to ensure that the office was solely focused and limited to its declared purpose as an information clearinghouse on insurance.

*"NAMIC was able to ensure that the final version of Dodd-Frank contained explicit prohibition against FIO becoming a **de facto** federal regulator."*

FIO is housed within the Department of the Treasury and is charged with monitoring all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurance that could contribute to a systemic crisis. FIO will collect and analyze data on insurance; advise the Secretary of the Treasury on major domestic and international policy issues; establish federal policy on international insurance matters; and, ensure that state insurance laws remain consistent with federal policy in coordinating international trade agreements.

NAMIC was able to ensure that the final version of Dodd-Frank contained an explicit prohibition against FIO becoming a *de facto* federal regulator. A "savings clause" in the title of the bill creating FIO specifically preserves the state-based regulation of insurance.

The administrative process of implementing FIO began very slowly. For many months following the passage of Dodd-Frank, FIO was an agency in name only – it had no leader, few staff members and little funding. This holding pattern ended with the naming of Illinois Department of Insurance Director Michael McRaith as the first Director of FIO. Director McRaith officially took over as head of the new office in June 2011.

As part of the mission of the FIO, the director is required to submit several reports to Congress. Beginning on September 30, 2011, the FIO director must submit two annual reports to the President and to the House Financial Services and Senate Banking Committees. The first report will outline any actions taken by the office regarding the preemption of state insurance laws; the second report will examine the insurance industry and any other information deemed relevant by the FIO director or requested by Congressional committees.

In addition to the annual reports, the FIO director is responsible for conducting a study on how to modernize and improve the system of insurance regulation in the United States. This study is due to be released in January 2012.

NAMIC is concerned that any office tasked with producing a report regarding the industry which it oversees and for which it responsible will naturally ask for more authority to oversee that industry – in fact, the last administration blueprint on the issue had already called for increased federal regulation. With the short turn-around time between Director McRaith taking control of FIO and the due date for the study, it is believed that a study calling for increased federal regulation of insurance is even more likely.

During a Senate Banking Committee on oversight of the Dodd-Frank implementation process last May, Treasury officials testified on the current state of the new Federal Insurance Office.

Addressing concerns that FIO remains understaffed and underutilized 10 months after passage of Dodd-Frank, Treasury stated that FIO is adequately staffed and has served an "important consultative role" during Dodd-Frank implementation. Treasury cited their participation in such matters as development of the Volcker rule and orderly liquidation authority regulations.

In addition, Treasury stated that FIO staff has participated in deliberations and rulemaking activities by the Financial Stability Oversight Council (FSOC) – the new systemic risk regulator created by Dodd-Frank to determine what financial companies may create risk to the nation's financial system.

In his role as Illinois Director and as an officer with the National Association of Insurance Commissioners, Director McRaith was a strong advocate for the state-based regulation of insurance. NAMIC hopes that his long-standing support for the current system of solvency regulations, guarantee funds and consumer protections guides him in his new role at the federal level.

One year after the passage of Dodd-Frank, FIO has yet to issue any administrative rulemakings. However, this stasis is predicted to change dramatically once the office becomes fully functional. The possible expansion of FIO is a priority concern and implementation of the office is being very closely watched.

Federal Advisory Committee on Insurance

Directly related to FIO is a new Federal Advisory Committee on Insurance (FACI). FACI will provide advice and recommendations to the FIO and will assist Director McRaith to carry out his responsibilities on FSOC. On May 13, 2011, a notice in the Federal Register requested applications for positions on FACI which will be made up of 15 members. Half of the seats are reserved for state insurance regulators while the other FACI members will represent "distinguished members of the property and casualty insurance industry, the life insurance industry, the reinsurance industry, the agent and broker community, academics and consumers."

NAMIC worked to see that qualified applicants included at least one mutual company CEO, ensuring mutual insurance companies are afforded a voice. The mutual insurance industry differs significantly from others in the insurance market and should be represented on FACI. The appointment process is just beginning but a response from Treasury is anticipated in the coming weeks.

Financial Stability Oversight Council

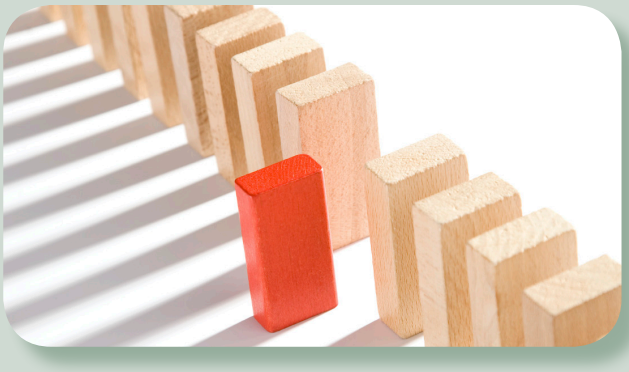
While the development of FIO is perhaps NAMIC's foremost concern, it is by no means the only new office created by Dodd-Frank that will impact the business of insurance. The office that perhaps has received the most attention from the broader financial services industry since passage of Dodd-Frank – and one with which NAMIC has already been engaged in response to rulemakings – is the Financial Stability Oversight Council.

FSOC is the newly-established body charged with monitoring systemic risks to the nation's economy by identifying those risks and closing regulatory gaps. It is made up of ten voting members (nine representatives from federal financial regulatory agencies and an "independent member with insurance expertise") and five nonvoting members, including the new FIO Director and a state insurance commissioner selected by the National Association of Insurance Commissioners.

For many months, only one insurance position was filled on FSOC – the nonvoting state commissioner. John M. Huff (MO), is serving as the state commissioner – however, his full ability to effectively represent insurance before FSOC remains hampered by a lack of staff and an embargo on discussion of FSOC activities with other parties.

The absence of any insurance expertise with voting power kept the insurance industry from being adequately represented on FSOC as it engaged in preliminary rulemaking activities that impacted insurance.

On October 6, 2010, FSOC issued two requests for comment. The first was a notice of a proposed rulemaking regarding the possible systemic risk regulation of nonbank financial companies – including insurance companies. The second was a request for public input on a study FSOC must undertake on Dodd-Frank provisions that prohibit banking institutions from engaging in proprietary trading and from establishing certain relationships with hedge and private equity funds. These prohibitions are commonly known as the "Volcker Rule."



NAMIC responded with comments that reiterated its long-standing positions that the mutual property/casualty insurance industry did not contribute to the economic crisis, does not create any current systemic risk, and is adequately regulated at the state level. NAMIC also advised FSOC that the best way to adequately accommodate the business of insurance while applying Volcker Rule restrictions on banking entities is to simply recognize the explicit exclusion for insurance companies with affiliated banking institutions that Congress included in Dodd-Frank, and to not overreach. These comments were submitted on November 5, 2010.

On January 18, 2011, FSOC released its study and recommendation on the Volcker Rule and its findings in anticipation of continued rulemaking on the regulation of nonbank financial companies. It is evident from these two documents that FSOC reviewed NAMIC's comments and incorporated our views into their findings. NAMIC was encouraged that our arguments were given significant weight by the council.

Michael McRaith
FIO Director

Following complaints about the prolonged delay on filling the insurance slots on FSOC from Members of Congress, NAMIC, and others in the insurance industry , Illinois Department of Insurance Director Michael McRaith was finally named the first Director of FIO on March 17, 2011. He officially took over that position and the corresponding seat on FSOC the first week of June, 2011.

Soon after, on June 24, 2011, S. Roy Woodall, a former Kentucky insurance commissioner, was named to fill the final insurance slot on FSOC. Woodall is a former president of the National Association of Life Companies and has worked at the Treasury Department in both the George W. Bush and Obama administrations, primarily overseeing terrorism-risk-insurance issues. He has also been a consultant on insurance issues with the Congressional Research Service.

It now remains to be seen whether Woodall can be confirmed in the Senate. Republican senators continue to block key Obama administration appointments – particularly those filling roles related to Dodd-Frank. Woodall is seen by many in the insurance industry and on Capitol Hill as a safe choice for a nominee. Withholding confirmation for that spot would not prevent FSOC from proceeding with rulemakings that could impact the insurance industry. In addition, Woodall has a Kentucky background – perhaps giving him good standing with Senate Republican Leader Mitch McConnell, R-Ky.

The Federal Reserve (Fed) also plays a large role in the implementation of Dodd-Frank and has issued several rulemakings that could impact insurance.

NAMIC responded to a rulemaking by the Fed that would have significantly changed disclosure requirements for credit insurers. NAMIC submitted comments to the Fed that explained that the proposed rule would pre-empt state-based insurance regulation on this matter and would deter consumers from obtaining products designed to help them meet their debt obligations in the event of future adverse circumstances.

In April of this year, NAMIC submitted comments to the Fed on proposed reporting forms for savings and loan holding companies that could impact NAMIC members that have a thrift subsidiary.

Sen. Sherrod Brown
D-Ohio

During a Senate Banking Committee hearing entitled "Oversight of Dodd-Frank Implementation: Monitoring Systemic Risk and Promoting Financial Stability" and while addressing FSOC and systemic risk Sen. Sherrod Brown, D-Ohio, asked whether any mutual insurance companies would be regarded as being systemically significant. Treasury officials responded that, "it would be premature" to comment on that. NAMIC had met with Sen. Brown earlier that week to discuss how Dodd-Frank created FIO within the Department of the Treasury. This hearing is one of many that will be held by both the Senate and House to examine the increased regulatory burden on the financial services industry created by the Dodd-Frank legislation.

NAMIC has continuing concerns about the ability of insurance to be effectively dealt with on FSOC and remains vigilant during the ongoing implementation of Dodd-Frank to ensure FSOC does not overstep its congressionally-defined bounds and drag insurance issues back into the Dodd-Frank regulatory scheme.

In the coming months, it is anticipated that FSOC will be releasing many more notices of rulemaking that could impact insurance. Foremost among these is a final determination on the practical definition of a "Systemically Important Financial Institution" (SIFI). In other words, what exactly makes an individual financial services entity "too big to fail" and therefore subject to federal oversight. NAMIC believes that no mutual property/casualty insurers should be considered SIFIs and will be working with FSOC to ensure this.

Consumer Financial Protection Bureau

While FSOC is the new office created by Dodd-Frank that has received the most attention since the bill's passage, the Consumer Financial Protection Bureau (CFPB) is the office that received the most attention during the bill's creation. The primary effect of this is that FSOC is up and running – meeting five times and issuing several rulemakings – while CFPB has taken a much slower path. This can be attributed to widespread financial services industry opposition to the need for such an office, corresponding opposition on Capitol Hill, legislative efforts to roll it back or cut its funding, and the continued lack of a director for the office.

Creation of a new, independent federal financial consumer protection agency was the centerpiece of the Obama Administration's financial services regulatory reform package released in the summer of 2009. The new CFPB was included in the Dodd-Frank financial services regulatory reform bill and is charged with overseeing all consumer protection rulemaking and regulations with regard to consumer financial products and services. The various consumer protection sections of the existing federal financial regulatory agencies were removed and placed within this large, new agency.

Insurance consumer protections are well regulated at the state level. NAMIC believes that if CFPB is given any jurisdiction over insurance consumer protections it will lead to dual regulation by both the federal and state governments as well as conflicts between consumer protections laws administered by other federal agencies.

NAMIC aggressively urged both the administration and Congress against the inclusion of property/casualty insurance products in CFPB oversight because insurance products are adequately regulated at the state level. This message was heard loud and clear and most lines of insurance were properly excluded from the office. However, in the original legislative drafts by both the administration and Congress, credit, mortgage and title insurance were still included.

Some policymakers believed that these few lines should be included because they deal with an extension of credit. NAMIC disagreed and pointed out that these lines are not tied to the extension of credit itself.

Through NAMIC's efforts, and as the legislation moved through Congress, these lines were ultimately removed and all lines of insurance are excluded from the jurisdiction of the CFPB.

The new Republican majority in the House is taking steps to limit the power of the CFPB as part of its overall effort to repeal certain parts of Dodd-Frank.

Currently, the CFPB is an independent agency funded by fees banks pay into the Federal Reserve – placing it outside the congressional appropriations process. In February the Republicans passed a continuing resolution to fund the government through the end of September that limited the amount the CFPB can receive from the Federal Reserve to $80 million. The administration has stated the agency needs $143 million this year – and current law would allow it receive as much as $500 million per year in future years.

"NAMIC aggressively urged both the administration and Congress against the inclusion of property/casualty insurance products in CFPB oversight because insurance products are adequately regulated at the state level."

In addition, legislation has been introduced in the House that would move the CFPB from the Federal Reserve to the Treasury – making it part of the normal appropriations process and affording Congress a greater say in how it operates.

In May, the House Financial Services Committee voted in favor of three bills to bring oversight and accountability to the CFPB. The three bills would make much needed changes to this unwieldy new office as it begins to take shape and commences its initial Dodd-Frank implementation activities.

- The Responsible Consumer Financial Protection Regulations Act, would place the CFPB under the direction of a five-member, bipartisan commission rather than a single director appointed by the President. This mirrors the administrative design of other independent federal agencies such as the Consumer Product Safety Commission, the Federal Communications Commission, and the Securities and Exchange Commission.

- The Consumer Financial Protection Safety and Soundness Improvement Act would clarify that the FSOC must set aside any CFPB regulation that is inconsistent with the safety and soundness operations of the nation's financial institutions.

- Currently under Dodd-Frank, FSOC can set aside CFPB regulations only if two-thirds of the FSOC's 10 voting members decide that the regulation would put the safety and soundness of the entire financial system at risk. The bill would change the vote required to set aside regulations from two-thirds of the FSOC to a simple majority and give the FSOC sufficient time to consider any safety and soundness implications.

- The Bureau of Consumer Financial Protection Transfer Clarification Act would ensure a Senate-confirmed Director of the CFPB is in place before any transfer of regulatory authority to the new bureau takes place. If the CFPB does not have a Senate-confirmed Director by July 21, 2011, CFPB may continue to operate under the Treasury Secretary's authority.

While insurance has been specifically excluded from the jurisdiction of the CFPB, NAMIC applauds congressional efforts to reduce its scale and scope. This large new bureaucracy promises to be far-reaching and could impact insurance in some ways. This could include possible expansion of the Fair Credit Reporting Act and other privacy reporting requirements, among others.

Even as Congress looks to restrict CFPB activities, the new agency has begun issuing notices of rulemaking. On March 9, 2011, CFPB issued a request for comments on the new office's information and complaint collection activities. As part of its activities, CFPB must collect and respond to various complaints regarding financial products and services. While insurance is excluded from its jurisdiction, and insurance is not specifically mentioned in the request for comments, it is easy to imagine that consumers may direct insurance complaints to the CFPB. NAMIC submitted comments insisting that any insurance complaints collected by CFPB be immediately removed from any database and forwarded to the appropriate state regulator.

This is just one unforeseen instance where CFPB could become directly involved with the state-regulated business of insurance. Once fully up and running, the CFPB rulemaking process promises to be swift and sizable.

As implementation of Dodd-Frank goes forward it is evident that NAMIC must ensure that the agency does not exceed its mandated authority and recognizes the explicit exclusion of insurance from its jurisdiction. This large new bureaucracy will be far-reaching and could impact insurance in many ways.

Office of Financial Research

One new office created by Dodd-Frank that has gotten very little attention but which could have a large impact is the Office of Financial Research (OFR).

Dodd-Frank created the OFR within the Department of the Treasury. The OFR is charged with improving the quality of financial data available to policymakers and facilitating analysis of the financial system for agencies such as FSOC that monitor systemic risk. To execute these functions, the OFR has two primary operational centers: a Data Center to standardize, validate, and maintain data to help regulators identify vulnerabilities in the financial system as a whole, and a Research and Analysis Center to conduct, coordinate, and sponsor research aimed at improving regulation of financial firms and markets.

The OFR will conduct financial analysis in support of FSOC, attempt to standardize financial reporting requirements, develop a reference database, prioritize making financial data efficient and secure, and produce regular reports to Congress on threats to the financial system and its key research and findings.

Early on, NAMIC expressed its concern with creation of the OFR and its potential conflict with FIO and state insurance regulators. While certain safeguards were written into Dodd-Frank to prevent these conflicts there remain concerns that the jurisdiction of the OFR is vague. A potential exists for the office to grow beyond its scope as an information clearinghouse for FSOC and Congress. In addition, the OFR has the power to subpoena financial companies for information. While the property/casualty insurance industry will not be a likely focus for systemic risk information gathering, there remains the possibility that this tool could be used to reach insurers.

OFR has not issued any rulemakings yet and seems to be the slowest of the new Dodd-Frank offices to get up and running. However, because of the very broad mandate afforded this office, it is expected that we will be responding to its activities sooner rather than later.

Conclusion

NAMIC has worked effectively to ensure our industry was not the target of the Dodd-Frank reforms. However, these efforts continue in earnest as the process of implementing the many reforms in this bill gets underway. NAMIC will work with Congress and the administration to ensure that the property/casualty insurance industry remains immune from the major provisions of Dodd-Frank. Most importantly, NAMIC will be working with its members to address any issues with Dodd-Frank that will inevitably arise along this long road to full implementation.

2010

July 21	President signs the "Wall Street Reform and Consumer Protection Act," sponsored by U.S. Senator Christopher Dodd (D-Conn) and U.S. Rep. Barney Frank (D-Mass)
October 6	FSOC issued request for comment on proposed rulemaking regarding the possible systemic risk regulation of nonbank financial companies – including insurance companies
	FSOC issued request for comment on a study FSOC must undertake on Dodd-Frank provisions that prohibit banking institutions from engaging in proprietary trading and from establishing certain relationships with hedge and private equity funds (prohibitions commonly known as the "Volcker Rule")
November 5	NAMIC submits comments to FSOC reiterating its long-standing positions that the mutual property/casualty insurance industry did not contribute to the economic crisis, does not create any current systemic risk, and is adequately regulated at the state level. NAMIC also advised FSOC that the best way to adequately accommodate the business of insurance while applying Volcker Rule restrictions is to recognize the explicit exclusion for insurance companies with affiliated banking institutions

2011

January 18	FSOC released study and recommendation on the Volcker Rule and findings in advance of continued rulemaking on the regulation of nonbank financial companies; NAMIC views were evident in the two documents
February 19	House Republicans passed a continuing resolution to fund the government through the end of September and limiting the amount the CFPB can receive from the Federal Reserve to $80 million; the administration stated the agency needs $143 million this year, while current law would allow it receive as much as $500 million per year in future years
March 9	CFPB issued a request for comments on the new office's information and complaint collection activities
March 17	Michael McRaith, director of the Illinois Department of Insurance, named the first director of the Federal Insurance Office
May 12	Treasury officials testified at Senate banking committee on the current state of the new FIO, and declined to say whether any mutual insurance companies would be regarded as being systemically significant
	House financial services committee voted in favor of legislation to bring oversight and accountability to the CFPB
May 13	Federal Register Notice requested applications for positions on a new Federal Advisory Committee on Insurance made up of 15 members
June	McRaith takes office as FIO director
June	S. Roy Woodall of Kentucky, former life insurance executive and state insurance commissioner, named to fill the final FSOC insurance slot
July 21	If the CFPB does not have a Senate-confirmed director, CFPB may continue to operate under the Treasury secretary's authority
September 30	Deadline for FIO director to submit annual reports to the President and the House financial services and Senate banking committees

2012

January	FIO study due on how to modernize and improve the system of insurance regulation

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