National Organization of Life & Health Insurance Guaranty Associations

NCIGF
National Conference of Insurance Guaranty Funds

November 17, 2010

JOINT COMMENTS OF NOLHGA AND NCIGF REGARDING PROPOSED RULE

The National Organization of Life and Health Insurance Guaranty Associations and the National Conference of Insurance Guaranty Funds respectfully submit their joint comments on the FDIC's proposed rule on Dodd-Frank Resolution Authority (the "Proposed Rule"). Under existing State law, the value of an insurance company's subsidiaries is reflected on the insurance company's financial statements and can be used to satisfy the claims of policyholders. As explained below, the Proposed Rule would undermine the policyholder protections afforded by existing law.

Background

Section 380.6 of the Proposed Rule seeks to implement Section 204(d) of the Dodd-Frank Act. NOLHGA and NCIGF expressed concern about Section 204(d) to Congress and the FDIC prior to enactment of the legislation. (See our joint comments attached as Exhibit A.) We were concerned that Section 204(d)(4) would permit the FDIC to take actions with respect to a covered financial company parent that could weaken an otherwise healthy downstream insurance company (or further weaken an already troubled insurance company) by diminishing the value of the insurance company's subsidiaries. In particular, our comments focused on the possibility that the FDIC could lend money to the covered financial company parent and take a lien on assets of covered subsidiaries, including subsidiaries owned by the downstream insurance company.

Our understanding, based on conversations with staff, was that the FDIC did not believe Section 204(d)(4) was intended to permit that result. Instead, the FDIC believed that Section 204(d)(4) was intended to protect the FDIC (and taxpayers) in connection with transactions with third parties that are not affiliated with a covered financial company. For example, if the FDIC sells the downstream insurance company and its subsidiaries to a third party and provides financing in connection with the sale, the FDIC could take a lien on the assets of the subsidiaries to secure the buyer's payment obligation.

We submitted proposed clarifying language regarding Section 204(d) (which we discussed in advance with the FDIC) to Senator Dodd, with the hope that it would be included in the conference report or otherwise placed on the record. Senator Dodd agreed with the proposed clarification and read it into the record, as follows:

> Mr. President, I would like to clarify the intent behind one of the provisions in the conference report to accompany the financial reform bill, H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 204(d) contemplates that the FDIC, as receiver, may take a lien on assets of a covered financial company or a covered subsidiary. With respect to assets of a covered subsidiary that is an insurance company or a direct or indirect subsidiary of an insurance company, I believe that the FDIC should exercise such authority cautiously to avoid weakening the insurance company and thereby undermining policyholder protection. Indeed, any lien taken on the assets of a covered subsidiary that is an insurance company or a direct or indirect subsidiary of an insurance company must avoid weakening or undermining policyholder protection. As a result, the FDIC should normally not take a lien on the assets of such a covered subsidiary except where the FDIC sells the covered subsidiary to a third party, provides financing in connection with the sale, and takes a lien on the assets of the covered subsidiary to secure the third party's repayment obligation to the FDIC. I understand that the FDIC intends to promulgate regulations consistent with this view.

156 Cong. Rec. S5927 (daily ed. July 15, 2010) (Statement of Sen. Dodd).

Section 380.6(b) of the Proposed Rule

Section 380.6(b) of the Proposed Rule is generally consistent with the intent expressed by Senator Dodd, except that it is overly broad. It purports to give the FDIC authority to impose liens on covered financial companies, covered subsidiaries *and their affiliates* – even though liens on affiliates are not authorized by Section 204(d) of the Dodd-Frank Act. Accordingly, the references to affiliates in Section 380.6(b) should be deleted.

Section 380.6(a) of the Proposed Rule

Section 380.6(a) of the Proposed Rule appears to be inconsistent with the intent expressed by Senator Dodd because:

- It would give the FDIC discretion to lend money to a covered financial company parent and take a lien on assets of covered subsidiaries owned by a downstream insurance company; and

- Such a lien *necessarily* would diminish the value of the subsidiaries and thereby weaken policyholder protection.

Except for the circumstances described in Section 380.6(b), the FDIC should take a lien on assets owned by an insurance company's subsidiaries (or by the insurance company itself) only to secure repayment of funds provided *to the insurance company or its subsidiaries*.[1]

For the foregoing reasons, we respectfully request that Section 380.6 of the Proposed Rule be revised as follows:

§ 380.6 Limitation on liens on assets of covered financial companies that are insurance companies or covered subsidiaries of insurance companies

(a) In the event that the Corporation makes funds available to a covered financial company that is an insurance company or ~~is~~ to a covered subsidiary ~~or affiliate~~ of such a covered financial company~~an insurance company~~ or enters into any other transaction with respect to such covered entity under 12 U.S.C. 5384(d), the Corporation will exercise its right to take liens on some or all assets of such covered entities to secure repayment of any such transactions only when the Corporation, in its sole discretion, determines that:

(1) taking such lien is necessary for the orderly rehabilitation or liquidation of the ~~entity~~covered financial company;
and
(2) taking such lien will not either unduly impede or delay the liquidation or rehabilitation of such insurance company, or the recovery by its policyholders.

(b) This section shall not be construed to restrict or impair the ability of the Corporation to take a lien on any or all of the assets of any covered financial company or covered subsidiary ~~or affiliate~~ in order to secure financing provided by the Corporation or the receiver in connection with the sale or transfer of the covered financial company or covered subsidiary ~~or affiliate~~ or any or all of the assets of such covered entity.

(c) Except as permitted by this section, the Corporation shall not take a lien on assets owned by (1) an insurance company or (2) a covered subsidiary that is a direct or indirect subsidiary of an insurance company.

[1] We note that the FDIC would be authorized to make funds available to an insurance company only upon its appointment as receiver of such company, and it is not clear that could ever happen. Under Section 203(e)(3) of the Dodd-Frank Act, the FDIC may stand in the place of the domestic insurance regulator and file "the appropriate judicial action in the appropriate State court to place such company into orderly liquidation under the laws and requirements of the State." There is no indication that the FDIC should be appointed receiver as a result of such filing.

Exhibit A

National Organization of Life & Health Insurance Guaranty Associations

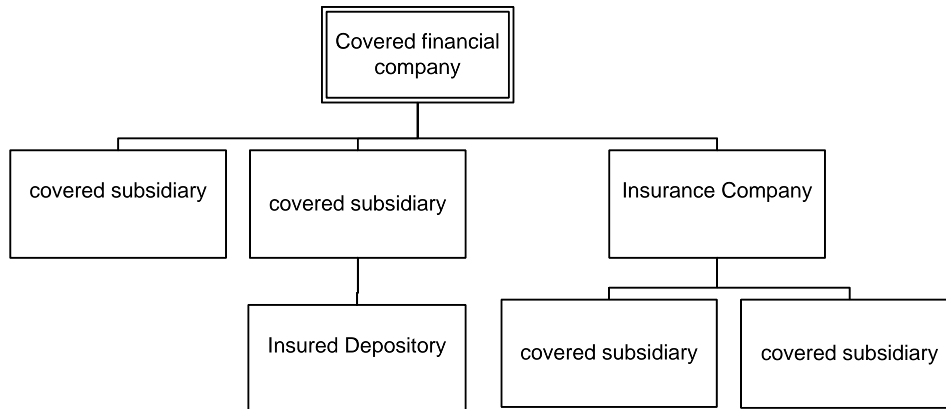
NCIGF National Conference of Insurance Guaranty Funds

May 6, 2010

JOINT COMMENTS OF NOLHGA AND NCIGF REGARDING SECTION 204(d) OF S. 3217, AS AMENDED BY SA 3822

The National Organization of Life and Health Insurance Guaranty Associations and the National Conference of Insurance Guaranty Funds respectfully submit their joint comments on Section 204(d) of S. 3217 (the "Senate bill"), as amended by SA 3822. Under existing State law, the value of an insurance company's subsidiaries is reflected on the insurance company's financial statements and can be used to satisfy the claims of policyholders. As explained below, amended Section 204(d) could eliminate that value and undermine policyholder protection.

Let's assume that a covered financial company (as defined in Section 201(7) of the Senate bill) owns an insurance company, a federally insured depository and several other direct and indirect subsidiaries. Under Section 201(6) of the Senate bill, each of the subsidiaries will be deemed to be a "covered subsidiary," except for the insurance company and the federally insured depository.



The insurance company in our example may not be insolvent. In fact, thanks to the States' efforts to monitor and safeguard the claims paying ability of insurers, insurance companies often remain financially secure even after their parent company fails. Unfortunately, Section 204(d) would permit the FDIC to take certain actions as receiver of the covered financial company that could have the unintended consequence of weakening the otherwise healthy insurance company.

Specifically, Section 204(d) would authorize the FDIC to lend money to the covered financial company and take a lien on certain assets, including assets owned by covered subsidiaries *that are downstream from the insurance company*. If the covered financial company fails to repay the loan, the FDIC could foreclose on the lien and sell the encumbered assets – thereby

diminishing (or eliminating) the value of the subsidiaries and leaving the insurance company in a weakened financial condition. If the insurance company becomes insolvent while the lien is still in place, the encumbered assets would not be available to pay the claims of policyholders or guaranty associations.

To preserve policyholder protections afforded by existing law, no lien on assets owned by covered subsidiaries that are downstream from insurance companies should be permitted. Accordingly, Section 204(d)(4) should be amended as follows:

1 (4) taking a lien on any or all assets of the
2 covered financial company or any covered subsidiary (other
3 than a covered subsidiary that is a direct or indirect
4 subsidiary of an insurance company),
5 including a first priority lien on all unencumbered
6 assets of the covered financial company or any such cov-
7 ered subsidiary to secure repayment of any trans-
8 actions conducted under this subsection;