Dodd-Frank Section 616: Source of Financial Strength

- State insurance regulation creates walls around insurance companies operating within large, diverse financial groups so that assets to pay claims for a damaged home or a deceased bread winner are not jeopardized by risk taking or poor management elsewhere within the firm.

- The Dodd Frank Act requirement that a holding company and its affiliates serve as a source of financial strength for a bank within the same group could jeopardize those critical walls around some insurers organized as Savings and Loan Holding Companies (SLHCs).

- As the Federal Reserve implements these rules, we urge them to leave the walls around insurers intact so that policyholders remain protected from the complex bets and risk taking that could threaten other parts of these holding company structures.

Background

The Federal Reserve has traditionally taken the view that a holding company’s failure to assist a troubled subsidiary Insured Depository Institution (IDI) when in a position to provide support is an unsafe and unsound banking practice, a violation of Regulation Y, or both. Section 616(d) of Dodd-Frank amended the Federal Deposit Insurance Act by adding Section 38A, codifying the requirement that a SLHC (or for that matter, any company that directly or indirectly controls an IDI) serve as a “source of financial strength” for any subsidiary IDI in financial distress. Section 616 goes on to define source of financial strength as “the ability of a company to provide financial assistance to the distressed depository institution,” and requires the appropriate Federal Banking agencies to issue final rules to carry out the section.

If the agency rules are written in such a manner as to require that a healthy insurer organized as a SLHC must not only be able to support, but is actually compelled to use its resources to provide capital funds to its troubled subsidiary depository, insurance policyholders will be disadvantaged, as the ability to pay out their claims will be undermined. Requiring state insurance regulator approval of any use of capital funds from the insurer would see to it that policyholders are represented and protected even in cases where a subsidiary IDI requires assistance.

Key Points

- Insurance companies are subject to very strict state capital and reserving requirements to protect policyholders by ensuring that an insurance company has sufficient funds to pay claims.

- Forcing an insurance company to use its resources to prop up troubled banks or thrifts could undermine its ability to pay out claims to customers for whom insurance triggering events come in times of greatest need. Insurance regulators recognize that there may be circumstances where it is appropriate and even beneficial for an insurer to provide assistance to a failing affiliated bank, however, bailing out poorly run or poorly regulated banks should not be at the expense of policyholders who acted responsibly and purchased insurance.

- Any rules implementing Section 616 of Dodd-Frank must give appropriate deference to insurance regulators to ensure policyholder interests are protected. If such rules do not appropriately protect policyholders, Congress should pass legislation providing such deference to ensure that insurance consumers are protected.

Ethan Sonnichsen, Director, Government Relations esonnichsen@naic.org
Mark Sagat, Counsel and Manager, Financial Policy and Legislation msagat@naic.org
Tony Cotto, Financial Policy and Legislative Counsel acotto@naic.org