View of Director John Huff, the State Insurance Commissioner Representative

I do not believe that there is a sufficient basis for the Council's final determination that Prudential's material financial distress could pose a threat to the financial stability of the United States. In particular, there appears to be a lack of recognition given to the nature of the insurance business and the authorities and tools available to insurance regulators. Insurance is not the same as a banking product yet the Statement of the Basis for the Council's Final Determination (the "Basis") inappropriately applies bank-like concepts to insurance products and their regulation, rendering the rationale for designation flawed, insufficient, and unsupportable. Consumers purchase insurance primarily to indemnify against a contingent event, protect against property loss or damage, replace the loss of income in the event of death or disability, and provide stable retirement income. Indeed, consumers seek insurance as a source of stability even in times of economic stress and the authorities of insurance regulators have long protected insurance consumers in difficult times such as the Great Depression and the recent financial crisis. For these and the following reasons, the analysis continues to be insufficient in several key respects:

1) The Basis identifies the asset liquidation channel as a primary concern regarding Prudential's potential threat to U.S. financial stability yet it offers merely speculative outcomes related to the liquidation of assets that are not supported by a sufficient understanding of the heterogeneity of insurance products or insurer asset disposition. There is little analysis linking realistic but severe liability run scenarios to readily available liquidity, liquidity obtained through asset sales, and the impact of such asset sales on financial markets. Without such analysis, it is difficult to attach any credibility to the conclusions in the Basis.

   The Basis discusses liabilities with certain withdrawal characteristics, presuming that a large majority of Prudential's policyholders would exercise withdrawal rights as depositors to a bank might. It suggests that a significant amount of Prudential's liabilities would be subject to policyholder surrender and payout, but summarily dismisses scenarios more supportable by the evidentiary record involving much lower amounts. In doing so, the Basis does not give sufficient weight to contractual provisions that allow Prudential to manage a significant amount of the potential withdrawals over a lengthy period of time and the ability of regulators to impose additional stays on surrenders. Rather, the Basis merely speculates, without any evidence, that the imposition of stays or contractual deferrals of surrenders would undermine confidence in insurance markets to such a degree that it would threaten the financial stability of the United States.

   In fact, all of these scenarios are highly unlikely as they effectively assume that all policyholders eligible to surrender their policies will do so despite the significant disincentives to policyholder withdrawals including federal income tax liability, federal income tax penalties, surrender penalties, and the loss of guarantees., which the Basis gives little weight. The Basis also asserts that policyholders, in deciding whether to surrender, would consider the amount of the death or retirement benefit as a less important consideration than the cash surrender value, which is much lower than the death benefit. It further argues that the more appropriate comparison would be between the cash surrender value and the "associated liabilities" (i.e., the reserve), explaining that the comparison to the death benefit does not take into account the time value of money or the payments policyholders would continue to make. This is simply incorrect. In making any decision to surrender an insurance policy, policyholders would not know the reserve amount of their policy (which requires an actuarial calculation to determine) and would instead consider the reason they purchased the policy, the death or retirement benefit. In light of this, it is beyond comprehension how policyholders would be able to or even why they would desire to make any other comparison except as between the cash surrender value and the death or retirement benefit. Most policyholders do not view their insurance policies as checking accounts, or even as typical investment accounts. Policyholders pay premiums to obtain the protection insurance provides.

The Basis also fails to demonstrate that the potential extent of the assets required to be liquidated to pay policyholder surrenders under such scenarios would be significant enough to pose a threat to the financial stability of the United States. In this context, the Basis does not give appropriate weight to evidence demonstrating that Prudential's holdings do not comprise a disproportionately large share of any asset market.

2) The exposure channel analysis is not a compelling basis for the final determination as it does not set forth sufficient evidence to conclude that Prudential's exposures to different counterparties are significant enough to pose a threat to the financial stability of the United States. The Basis also does not adequately analyze actions taken by Prudential's counterparties, which include several of the largest U.S. banks, or their regulators, which include several of my fellow Council members, to manage the risks arising from transactions with Prudential or other financial counterparties. In attempting to address the fact that individual exposures would not have a systemic impact, the Basis aggregates exposures and argues that together such exposures could pose a threat to the financial system of the United States. In so doing, the Basis merely demonstrates that Prudential is a large insurance company, yet it has been a long accepted principle of this process that size alone is not a sufficient basis for designation.

With respect to exposures to policyholders, the Council does not set forth a reasonable basis to conclude that the financial stability of the United States would be threatened if policyholders were unable to access cash surrender values or suffered losses in the event of Prudential's material financial distress. Accordingly, reliance on such scenarios is inappropriate. It also overstates the guaranty fund's importance to the analysis and does not sufficiently support the apparent conclusion that the impact of Prudential's failure on the guaranty fund system could pose a threat to the financial stability of the United States.

3) Some of the statements and arguments in the Basis suggest a lack of appreciation of the operation of the state-based regulatory framework, particularly its resolution processes. The Basis states that the authority of an insurance regulator to ring-fence the insurance legal entity could complicate resolution and could pose a threat to financial stability. Ring-fencing is a powerful regulatory tool utilized by insurance regulators to protect policyholders. In fact, ring-fencing augments financial stability by providing policyholders with the confidence that their policies will be honored, thereby reducing the likelihood and amount of policyholder surrenders as well as decreasing asset liquidation risk. Moreover, ring-fencing does not necessarily prevent a transfer of assets; rather it prevents the transfer of assets without regulatory approval. Accordingly, regulators—U.S. and international—can use this tool to ensure assets remain with the firm long enough to assess liabilities and determine the most appropriate approach to resolving the firm.

   In addition, while Prudential may be a complex organization as suggested by the Basis, it is not clear how that complexity translates into a threat to the financial stability of the United States as defined in the Council's rule and guidance, as the analysis does not properly take into account key elements of the insurance resolution process. Insurance regulators have a history of working together in judicially overseen and orderly resolutions.

4) The Basis also mischaracterizes, does not sufficiently consider, or otherwise ignores other regulatory authorities and tools. These authorities and tools include, but are not limited to, the ability to take over the company by placing it in administrative supervision or declaring it to be in hazardous financial condition, regulatory risk-based capital triggers, and the ability to stop or slow surrenders. In the event of Prudential's material financial distress or failure, insurance regulators have the authority to take action to minimize the impact that Prudential's failure would have on policyholders and counterparties. Given that one of the primary concerns is policyholder surrenders and the resulting asset liquidation, the ability of regulators to intervene to manage such surrenders is a critical component to any such analysis and should be given more recognition. Instead, the Basis speculates that the use of stays

or similar powers would undermine confidence in the insurance industry but provides no evidence to support that conclusion.

5) The Council indicated in its rule and guidance that it will consider a firm's material financial distress to be a threat to financial stability if there would be impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy. While there are conclusory statements in this regard throughout the Basis, there is insufficient analysis to support application of such statements to Prudential.

6) The Council also indicated in its rule and guidance that its determination will be made on a firm-specific basis. However, the Basis includes arguments that I do not believe meet that standard, such as concerns regarding state guaranty fund capacity and implicit application of such severe macroeconomic stress that it is unclear whether Prudential is even causing or amplifying the stress in question. Further, these arguments are presented with no limiting principle, which raises concerns that broad industry or macroeconomic related issues, rather than firm-specific issues, could subject a company to designation.

In conclusion, the designation of insurance companies that could pose a threat to the financial stability of the United States is a serious exercise, the result of which could have significant implications for 1) the stability of the financial system, 2) policyholders that may be disadvantaged to the benefit of financial counterparties, 3) the cost and availability of insurance products, and 4) the competitiveness of the insurance sector. It is critically important that these decisions are based on robust analytics and a thorough understanding of the insurance business and insurance regulation. The analysis contained in the basis for the final determination in large part relies on nothing more than speculation. It gives little weight, if any, to evidence in the record, the historical experience of the insurance sector, and the expertise and experience of insurance regulators and, in particular, my colleagues in the states of New Jersey, Connecticut, and Arizona that are primarily responsible for regulating Prudential.

For these reasons, I do not believe that the Council has a sufficient basis to conclude that Prudential's material financial distress could pose a threat to the financial stability of the United States.