State of Delaware

KAREN WELDIN STEWART, CIR-ML
INSURANCE COMMISSIONER

701 KING STREET, SUITE 602
WILMINGTON, DELAWARE 19801
(302) 577-1211
FAX (302) 577-1212

Department of Insurance
Bureau of Captive and Financial Insurance Products

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Via U.S. and Electronic Mail (RegComments@fhfa.gov)

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA39
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, D.C. 20522

Re: Comments for Advance Notice of Proposed Rulemaking
RIN 2590-AA39

Dear Mr. Pollard:

On behalf of Insurance Commissioner Karen Weldin Stewart, I submit the following comments to the Federal Housing Finance Agency (FHFA) regarding the Advance Notice of Proposed Rulemaking (ANPR). Because the ANPR is an advance notice, the Commissioner interprets it to be an information gathering device for the FHFA. Though the Commissioner applauds the fact that a federal agency seeks to increase its knowledge about the insurance industry, the proposals in the ANPR are ill advised and should be withdrawn. The Commissioner's view is that placing constraints on Federal Home Loan Bank (FHLB) membership, as proposed in the ANPR, only serves to place an unnecessary barrier upon insurance companies becoming and maintaining membership in the FHLB system.

The comments presented address two aspects of FHLB membership. First, whether insurance companies must maintain ten percent (10%) of their assets in residential mortgage loans throughout their membership period. Second, whether captive insurance companies should be FHLB members. The comments regarding the ten percent mandate apply to both captive and commercial insurers. Before addressing these proposals, the Commissioner first recommends the formation of a joint task force to explore the proposals in the ANPR.

Formation of a Joint Task Force. If the FHFA does not withdraw the ANPR, then in advance of considering the adoption of any proposal within the ANPR, the Commissioner encourages Acting Director DeMarco to form a task force that joins diverse entities. This task force should include the FHFA, insurance regulators, insurance industry, and FHLB member banks. The foremost mission of the task force will be to enhance the FHLB's existing knowledge about the insurance industry and why insurance companies value FHLB membership. The FHFA will benefit by learning more about the nature and operations of the insurance industry. Once a level of enhanced knowledge exists, the task force's next mission will be to explore the feasibility of the ANPR's proposals as those proposals relate to insurance. An example of how the FHFA can learn more relates to the narrative for question 13 in the ANPR. The narrative and question suggest that captive insurance companies are subject to a lesser degree of supervision than their commercial insurance counterparts. This displays a lack of understanding about captive insurance and the Commissioner is eager to dispel any such notion through the operation of the task force. A third mission of the task force should be the consideration of any changes to the Federal Home Loan Bank Act that permits insurance companies greater flexibility for FHLB membership.

The Commissioner not only recommends the creation of this task force, but is also ready to take the actions necessary to make it a reality. The Bureau of Captive and Financial Insurance Products (BCFIP) within the Delaware Department of Insurance stands ready to take a lead role in developing the mission statement for the task force and organizing it. As the domicile for 131 commercial insurance companies, as well as 101 captive insurers, Delaware has the unique attribute of having a strong mix of both types of insurers. This attribute makes Delaware the best fit to represent the interests of state insurance departments. The Commissioner recommends approaching individual insurers as well as insurance trade organizations to gauge their interest in participating as task force members. The BCFIP is willing to contact these parties and coordinate their participation. The FHFA and the insurance industry have a lot to learn from each other and the formation of a task force will facilitate this learning.

The Ten Percent Requirement. In questions two and three the ANPR proposes to mandate that insurers hold ten percent of their assets in residential mortgage loans for the duration of FHLB membership. The Commissioner views the mandate as conflicting with the sound management of investments, because such a requirement does not comport with the nature of insurance nor would it be a recommended asset level for an insurer's solvency. The nature of insurance is to insure risks - not make residential mortgage loans. The ten percent requirement creates an artificial mandate that may not allow an insurer to prudently invest assets.

Investment strategies differ from insurer to insurer based upon the type of risk insured. A property insurer maintains investments to pay claims in the event of a catastrophe such as hurricanes, earthquakes, and regional storms like tornadoes and hail storms. Additionally man-made events such a terrorism attack are factors that figure into investment considerations. Large catastrophic events result in the necessity of paying claims versus the consequence of liquidating investments at a loss in order to pay the claims.

Life insurers typically have long-term goals since the insurance promises made to pay life and annuity benefits are usually not fulfilled for years. An example of a factor that influences investment strategy is a life insurer's sensitivity to investment yields as they relate to the products they sell. This is spread risk. This risk is an incremental interest rate risk to Treasury interest rate risk. The spread or difference between an asset's yield and corresponding Treasury rate may change. Fraternal benefit societies also offer life and annuity products. Unlike traditional life insurance companies, fraternal societies must provide charitable benefits in order to fulfill a charitable mission. The charitable mission influences investment strategies. Religious fraternal societies invest in bonds issued by religious entities such as a Catholic diocese.

Health insurers face new and emerging challenges such as pandemic risk involving bacterial and viral strains that are immune to current vaccines and antibiotics. Biological terrorism risk is another consideration. Another new risk factor faced by health insurers is the affect of the Patient Protection and Affordable Care Act (PPACA). One PPACA mandate is the implementation of the medical loss ratio which will force insurers to pay rebates to policyholders when their loss ratio is below a certain minimum. In contrast, when losses exceed the minimum then insurers have restricted ability to recoup losses. These new and emerging challenges and risks are weighed when developing an investment strategy.

The nature of risks covered by insurance companies varies and investment strategies must comport to these risks. The imposition of the ten percent mandate would not benefit insurers. It would place an artificial "one size fits all" mandate upon insurers in spite of the fact that the insurers cover widely divergent risks.

Captive or Shell Insurance Companies. The Commissioner addresses the question whether captive insurance companies are subject to the degree of supervision contemplated by section 4(a)(1)(B) of the Federal Home Loan Bank Act, and whether they have a bona fide involvement in supporting housing finance. The answer is yes - captive insurance companies are subject to the degree of supervision contemplated by the Bank Act. This section of the Bank Act does not distinguish between commercial and captive insurance companies. The section simply states that insurance companies must be subject to inspection and regulation under the laws of a state. The regulatory law applicable to Delaware captive insurance companies is Title 69 of the Delaware Insurance Code. This title mandates a number of regulatory standards to include:

- Capitalization standards for forming and maintaining a captive insurer.

- Prior to March 1 of each year, each captive insurance company shall submit to the Commissioner a report of its financial condition, verified by oath of two of its executive officers or other authorized persons.

- Captive insurance companies are inspected and examined at least once every three years. The purpose of the inspection and examination is to ascertain its affairs, financial condition, its ability to fulfill its obligations, and its compliance with the provisions of Delaware laws.

- Each captive insurance company is subject to a comprehensive annual audit by independent auditors approved by the Commissioner.

- No captive insurance company may sell, exchange, lease, mortgage, assign, pledge or otherwise transfer or grant a security interest in, all or substantially all of the assets of the captive insurance company without the Commissioner's prior approval.

- No captive insurance company may incur any material indebtedness without the Commissioner's prior approval.

- No captive insurance company may make a material loan or other material extension of credit without the Commissioner's prior approval.

- No captive insurance company may make any material payment out of capital and surplus without the Commissioner's prior approval.

Though the above list is only a portion of the regulatory mandates imposed by the Delaware Insurance Code upon captive insurance companies, these mandates show that Delaware's regulatory structure satisfies the levels of inspection and regulation contemplated by the Bank Act. In regard to captive insurance companies having a bona fide involvement in support of housing finance, by including residential mortgage related assets in their portfolios, captive insurers are exhibiting the same level of support as commercial insurers.

Thank you for the opportunity to provide these comments. The Commissioner hopes that Acting Director DeMarco will form the recommended task force before considering the implementation of any proposals in the ANPR.

On Behalf of the Commissioner,

Steve Kinion
Bureau Director