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DRAFT

Via FHFA Website: www.fhfa.gov/open-for-comment-or-input

Alfred M. Pollard
General Counsel
Attn: Comments/RIN 2590-AA39
Federal Housing Finance Agency
400 Seventh Street, S.W.
Eighth Floor
Washington, DC 20024

Re: Proposed Rule (RIN 2590-AA39) Members of Federal Home Loan Banks

Dear Mr. Pollard:

The American Bankers Insurance Association ("ABIA"), the insurance subsidiary of the American Bankers Association, provides the following comments to the Federal Housing Finance Agency ("FHFA") concerning the referenced proposed rule.[1] ABIA is concerned about the proposal to define the term "insurance company" in a manner to prohibit a captive insurance company from being a member of a Federal Home Loan Bank ("Bank"). We note that ABA has filed a separate letter commenting on all aspects of the proposal. This letter, which focuses solely on the impact of the proposal on captive insurance companies may be considered supplemental and complementary to that letter.

The FHFA proposes to prohibit all captive insurance companies from being a member of a Bank by defining an "insurance company" as "a company whose primary business is the underwriting of insurance for nonaffiliated persons or entities."[2]
The FHFA's basis for the proposed regulatory prohibition is a "supervisory concern" that some captives are "created for the sole or primary purpose of serving as a funding vehicle for its parent or affiliates."

To solve that perceived problem, the FHFA proposes to ban *all* captive insurance companies from being a member of a Bank. But its proposed remedy is contrary to the generally-accepted meaning of the term "insurance company" as well as the mechanism in the FHLB Act and related regulations to address supervisory concerns.

[1] 79 Fed. Reg. 54848 (Sept. 12, 2014).
[2] Proposed Section 1263.1.

The FHFA's proposal would improperly limit the scope of the term "insurance company," which would be contrary to the normal meaning of the term.

The proposed definition of "insurance company" is contrary to the generally-accepted meaning of that term. For over 84 years, the Federal Home Loan Bank Act ("FHLB Act")[3] has permitted all insurance companies – without qualification – to be eligible for membership in a Bank. The statute reads: "*Any* . . . insurance company . . . shall be eligible to become a member of a Federal Home Loan Bank" if certain requirements are satisfied, including that the company "is subject to inspection and regulation under the banking laws, or under similar laws, of the State. . . ."[4] (Emphasis added.) While neither the FHLB Act nor its legislative history defines the term "insurance company," the term is defined elsewhere in federal law – in language that is not limiting.

The 1940 Investment Company Act defines an insurance company as "a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State. . . ."[5] That definition reads the same as the definition of the term in the Securities Act of 1933[6] – a law enacted just a year after the FHLB Act became law. Consequently, at the time Congress decided to permit insurance companies to be members of the Banks, the term "insurance company" was familiar to the legislators, and there is no indication Congress wanted to limit the meaning of the term.

The Department of the Treasury defines "insurance company" as "any person engaged within the United States as a business in the issuing or underwriting of any covered product" (various types of insurance and annuity contracts).[7] And *Black's Law Dictionary* defines an "insurance company" as "a corporation or association that issues insurance policies."[8]

We find nothing in the FHLB Act or any interpretations that give the FHFA any authority to define "insurance company" to mean anything other than the meaning that was generally accepted when the FHLB Act became law: a company that engages in the business of insuring or reinsuring risk.

3 Ch. 522, § 4, 47 Stat. 726.
4 12 U.S.C. § 1424(a)(1).
5 15 U.S.C. § 80a-2(a)(17).
6 15 U.S.C. § 7b(13).
7 31 C.F.R. § 1025.100(g).
8 Black's Law Dictionary (9th Ed.), p. 876.

The FHFA is proposing to address a supervisory concern in a manner that is inconsistent with the FHLB Act and regulations.

The FHFA states that it is proposing to prohibit a captive from being a member of a Bank out of "supervisory concerns,"[9] but its proposed solution to that perceived problem is contrary to the limited authority the FHFA is given under the FHLB Act to address supervisory concerns related to insurance companies. As stated in the McCarran-Ferguson Act,[10] the "business of insurance" generally is subject to state regulation. Thus, in establishing the eligibility requirements for membership in a Bank, the FHLB Act looks to state insurance law and regulatory oversight to assess the risk posed to a Bank by an insurance company member. Section 4 of the FHLB Act states that a company applying for membership in a Bank must be "subject to inspection and regulation under the banking laws, or under similar laws, of the State. . . ."[11] Section 8 requires the Director of the FHFA to examine state laws, regulations and procedures that govern how a member does business, and the Director is granted the authority to act where state regulation of a member inadequately protects a Bank regarding advances:

> If any such examination shall indicate, in the opinion of the board, that under the laws of any such State or the regulations or procedure thereunder there would be inadequate protection to a Federal Home Loan Bank in making or collecting advances under this Act, the Director may withhold or limit the operation of any Federal Home Loan Bank in such State until satisfactory conditions of law, regulation, or procedure shall be established. In any State where State examination of members or nonmember borrowers is deemed inadequate for the purposes of the Federal Home Loan Banks, the Director shall establish such examination, all or part of the cost of which may be considered as part of the cost of making advances in such State.[12]

Section 1263.6(a)(4) of the FHFA regulation implements these statutory provisions by requiring an applicant for membership in a Bank to demonstrate that its "financial condition is such that advances may be safely made to it. . . ."[13] And in the case of insurance companies, the regulation relies on state insurance regulators to assess an insurance company's finances: "An insurance company applicant shall be deemed to meet the financial condition requirement of [Section] 1263.6(a)(4) if, based on the information contained in the applicant's most recent regulatory financial report filed with its appropriate regulator, the applicant meets all of its minimum statutory and regulatory capital requirements and the capital standards established by the National Association of Insurance Commissioners" ("NAIC").[14] Consequently, as long as an insurance company satisfies the applicable statutory and regulatory capital requirements set forth by a state of domicile, the FHFA should be satisfied that there are no supervisory concerns. But by carving out captives from the definition of insurance company, the FHFA would be deeming

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9 79 Fed. Reg. 54848, 54853-54 (Sept. 12, 2014).

10 15 U.S.C. § 1012.

11 12 U.S.C. § 1424(a)(1)(A).

12 12 U.S.C. § 1428.

13 12 C.F.R. § 1263.6(a)(4).

14 12 C.F.R. § 1263.16(a).

a whole class of insurance companies as failing to meet the financial condition requirements of Section 1263.6.

Captives are subject to significant state insurance regulation.

Captive insurance companies often underwrite the risks of both affiliated and unaffiliated companies. Just like other types of insurance companies, captive insurance companies are subject to state regulatory requirements regarding supervision, solvency, receivership and liquidation. The fact that a captive insurance company insures affiliates does not mean that it is not subject to regulatory requirements designed to ensure that it is financially sound.

In states that are significant captive domiciles, such as Vermont, captive insurance companies are substantially regulated. Vermont has advanced, stringent captive laws, along with a dedicated captive regulatory and examination staff, which should satisfy any supervisory concerns. The Vermont Department of Insurance, like all captive domicile states, is accredited by the NAIC, which means that Vermont meets national financial and regulatory standards established by the NAIC. Vermont's regulation of captives includes:

- Minimum capital and surplus standards;
- Licensing requirements;
- Annual financial reporting requirements;
- Inspections and examinations by insurance department staff at least every three to five years; and
- Investment restrictions.

Vermont also prohibits a captive insurance company from paying a dividend or other distribution without the prior approval of the Vermont Commissioner of Insurance.

The FHFA states that inadequate oversight from state insurance regulators, combined with an alleged conflict between the interests of the captive and those of its parent, could pose a safety and soundness risk to a Bank, notwithstanding a captive's compliance with state regulatory requirements. Specifically, according to the FHFA:

> [C]aptives present a number of safety and soundness concerns for the Banks beyond those presented by insured depository institutions and traditional insurance companies. Among these are the potential that the captive's financial condition could worsen without the Bank's knowledge due to the relative unavailability of objective financial information and ratings as compared to other insurers and depository institutions; the financial condition of the captive, which operates to serve the parent, rather than in its own financial self-interest, may deteriorate rapidly due to the actions of the parent; the parent might decline to provide financial support, or to provide additional collateral, in

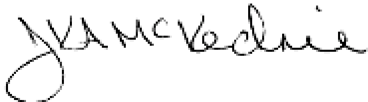
cases of financial distress; and that the captive's balance sheet may reflect non-diversified risk if its underwriting activities are narrowly prescribed by the parent.

By making these assertions, the FHFA implies that when it comes to the ability of captives to live up to their financial obligations vis-à-vis an advance from a Bank, the state-based system of insurance regulation is inadequate. But as discussed above, the FHLB Act and the FHFA's regulations are drafted so that the FHFA works with state insurance regulators to address these types of concerns.

Conclusion

The FHFA has provided no evidence to back up its assumptions and in fact has provided no evidence to justify treating captive insurance companies differently than mutual companies, stock companies, or other insurance companies. The proposed definition of "insurance company" would be contrary to how the term is usually defined and would alter the framework the FHLB Act has established to protect Banks regarding advances made to an insurance company member of a Bank. We urge the FHFA not to adopt the proposed definition of "insurance company."

Sincerely,



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