



**KAREN WELDIN STEWART  
INSURANCE COMMISSIONER**

January 12, 2015

Via U.S. and Electronic Mail

(RegComments@fhfa.gov)

Mr. Alfred M. Pollard  
General Counsel  
Attention: Comments/RIN 2590-AA39  
Federal Housing Finance Agency  
400 Seventh St. SW, 8<sup>th</sup> Floor  
Washington, D.C. 20024

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

Dear Mr. Pollard:

On behalf of Insurance Commissioner Karen Weldin Stewart, I am submitting the following comments to the Federal Housing Finance Agency (FHFA) regarding the above referenced Notice of Proposed Rulemaking (NPR). In summary, the Delaware Insurance Department opposes the proposal to prohibit captive insurance company membership in the Federal Home Loan Bank (FHLBank) system. The proposed prohibition is the result of the FHFA's lack of understanding and knowledge of the captive insurance industry.

The NPR is in many respects the same as the Advanced Notice of Proposed Rulemaking (ANPR) issued by the FHFA in 2011. When Delaware commented on the ANPR, Commissioner Stewart extended an offer to the FHFA to work together to address any captive insurance concerns the FHFA may harbor. Commissioner Stewart echoed this offer in her comments for Advisory Bulletin No. 2012-N-14 in December 2012. The FHFA never acknowledged either offer. After reading the NPR, the Commissioner and her staff conclude that the FHFA is not as fully informed about captive insurers as it should be. Therefore, for the third time

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Commissioner Stewart reiterates her suggestion that before the FHFA takes the unnecessary action of prohibiting captive insurers from becoming FHLB members and expelling existing member captives after five years, it should increase its knowledge of captive insurance by collaborating with captive insurance regulators and others in the captive insurance industry so that it may make an informed decision whether to continue with the proposed rulemaking.

#### **A. Captive Insurance Company Membership in the FHLBanks Benefits Society**

Commissioner Stewart is dedicated to bettering the lives of her constituents. One way to do so is via the affordable housing grants available from the FHLBank of Pittsburgh. Since 1990, the FHLBank of Pittsburgh<sup>1</sup> has awarded about \$183 million in affordable housing grants. These grants have created more than 28,000 housing units for low-income residents. Per federal law, all FHLBanks must set aside ten percent of their net income for affordable housing grants. In order to have money to award the grants, the FHLBanks must loan money and earn interest on their loans. If captive insurance companies are allowed to continue becoming members and borrowers, then borrowings will increase. When borrowings increase, the FHLBanks' net income increases. When net income increases, the amount of money available for affordable housing grants increases. When affordable housing grants increase, more affordable housing units for low-income residents can be built. However, when the FHFA imposes unnecessary membership limitations such as the NPR, these benefits will not accrue as they should. This is not a result that Commissioner Stewart wants. That is why she is opposed to the NPR, because if it goes into effect it will harm Delaware residents.

#### **B. The FHFA Does not Understand Captive Insurance**

The FHFA's lack of knowledge of captive insurance is shown at the bottom of page 26 of the NPR wherein it lists reasons why captives raise safety and soundness concerns for the FHLBanks,

In addition, captives 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 its own financial self-interest, may

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<sup>1</sup> Delaware, Pennsylvania, and West Virginia are in the district served by the FHLBank of Pittsburgh. Affordable housing organizations in these states are eligible for applying and receiving affordable housing grants from the FHLBank of Pittsburgh.

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.

In response, the Commissioner individually addresses the FHFA's purported reasons. First, is the purported reason 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***. In response the Commissioner notes that the financial information of an FHLBank member Delaware domiciled captive insurer is shared with the member captive's FHLBank. In spite of any confidentiality provisions in state law, the Commissioner requires full transparency and a close relationship between the member FHLBank and her captive bureau. Furthermore, all Delaware domiciled captive insurers that are FHLBank members must file quarterly financial reports which are shared with the member's FHLBank. What experience has shown is that Delaware captives that are either members or seeking to become FHLBank members are very open and receptive to transparency and the sharing of information between the FHLBank and the Delaware Insurance Department. In summary, the FHFA's concern that a captive's financial condition could worsen without the FHLBank's knowledge is a non-concern.

The second purported reason is that ***the financial condition of the captive, which operates to serve the parent, rather than its own financial self-interest, may deteriorate rapidly due to the actions of the parent***. This reason implies that the parent may drain the captive's resources in order to bolster itself. This reason also displays a complete lack of understanding of how captive insurance is regulated. The Delaware Insurance Department is experienced in dealing with cases in which an insurer's parent is suffering a financial deterioration. Our experience ranges from commercial insurers, e.g. AIG, to captive insurers. In all cases the insurer, whether it is commercial or captive, has continued to operate. The reason is because Delaware law requires that any material withdrawal of cash or other assets from a captive insurer must receive prior regulatory approval. Commissioner Stewart's directive to her captive team is that any withdrawal that places a captive insurer in financial jeopardy will not be approved.

The FHFA's third purported reason is that a captive's ***parent might decline to provide financial support, or to provide additional collateral, in cases of financial distress***. Again, this reason shows a lack of understanding of how captive insurers are regulated. Nearly all Delaware domiciled captives are regulated so that parental support is not needed in cases of financial distress. In other words, the captives are regulated and required to maintain a financial solvency level so that parental support is unnecessary. In the few captives where parental support is necessary, these captive insurers are subject to additional regulation and

monitoring. The solution is simple: The FHFA should avail itself of the opportunity to participate in the proposed task force to understand how this small number of captives is regulated.

The final purported reason is ***that the captive's balance sheet may reflect non-diversified risk if its underwriting activities are narrowly prescribed by the parent.*** If any reason reflects an entire lack of knowledge about captive insurance, it is this one. Of course a captive insurance company's parent prescribes the risks to be insured because that is what captive insurance is about. A captive insurance company insures the risks of its parent. It does so because in many cases the risk is unique to the parent and specific coverage is not available in the commercial market, or if coverage is available, it may be cost prohibitive. What the FHFA fails to realize is that because the captive insures its parent, the captive entirely understands and is familiar with the risk it is insuring. This level of in-depth knowledge mitigates the FHFA's concerns.

### **C. For the Third Time Commissioner Stewart Calls for the Creation of a Joint Task Force**

The FHFA should withdraw the NPR and agree to form a joint task force consisting of the FHFA, insurance regulators, representatives of the commercial and captive insurance industry, and FHLB member banks. One mission of the task force will be to enhance the FHFA's knowledge about the captive insurance industry and why captive insurance companies value FHLBank membership. Other missions for the task force to address can be the other issues raised in the NPR. Once a level of enhanced knowledge exists, the task force's next mission will be to consider the feasibility of the NPR's proposals as those proposals relate to insurance. The formation of and the FHFA's participation in this task force will be consistent with the recommendations contained in the March 18, 2013 report issued by the FHFA's inspector general.<sup>2</sup> The report cites the FHFA for not coordinating with state insurance regulators and standard setting groups like the National Association of Insurance Commissioners. The report recommends that the FHFA establish mechanisms to obtain more information from state regulators and NAIC working groups.

The Commissioner not only recommends the creation of this task force, but is also ready to devote the time and resources necessary to make it a reality. The Delaware Department of Insurance stands ready to not only take a lead role in developing the mission statement and direction for the task force, but to also organize it and ensure its success. As the third largest

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<sup>2</sup> Federal Housing Finance Agency Office of Inspector General, *FHFA Can Enhance its Oversight of FHLBank Advances to Insurance Companies by Improving Communication with State Insurance Regulators and Standard-Setting Groups*, Audit Report: AUD-2013-006, March 18, 2013.

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captive domicile in the United States and the sixth largest in the world, Delaware has the experience and knowledge to take a leading role.

Thank you for the opportunity to provide these comments and your consideration of them. Commissioner Stewart hopes that Director Watt will set aside the NPR and agree to form the recommended task force.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Kinion". The signature is fluid and cursive, with a large initial "S" and "K".

Steve Kinion  
Director  
Bureau of Captive and Financial Insurance Products