Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

October 13, 2014

Honorable Jacob Lew
Secretary
Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Dear Secretary Lew:

On September 4, 2014, MetLife, Inc. ("MetLife") announced that the Financial Stability Oversight Council ("FSOC") had made a "proposed determination" that MetLife should be designated a nonbank systemically important financial institution ("SIFI") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

As one of MetLife's lead insurance regulators, I am writing today at my own initiative to urge you and the rest of your FSOC colleagues to reconsider your proposed determination. Based on my experience as an insurance regulator, and a regulator of one of MetLife's larger insurance subsidiaries, I do not believe that MetLife's businesses and corporate structure create the kind of systemic risk that Dodd-Frank's SIFI designation process was designed to address.

MetLife is a highly-regulated insurance group overseen by competent regulators not only in the states of domicile of its insurance subsidiaries, but in every state in which the company is licensed. Each state receives a wealth of financial and other company data from MetLife about the insurance subsidiaries it supervises, and each state in which a MetLife insurer is licensed has the right to request additional information from those companies. MetLife's insurance subsidiaries, which represent the vast majority of MetLife's assets, are also subject to audits and examinations by their domestic regulators. For the reasons I elaborate in greater detail below, MetLife, as an insurance group that conducts the preponderance of its activities in regulated insurance operating companies, is a well-regulated insurance group, and simply is not vulnerable to material financial distress to a degree that would pose systemic risk. State regulators have proven, time and again (most recently in 2008), that they are competent and effective regulators of the insurance industry. As the MetLife group does not engage in any significant non-insurance activities, let alone activities that would create systemic risk, another layer of oversight over MetLife's activities is redundant, unnecessary and will only serve to impede the quality of service MetLife provides to its customers and the value it delivers to its shareholders.

Delaware ranks as the 10th largest insurance market in the United States by premiums written, and the Delaware Department of Insurance supervises many insurers, including one of MetLife's largest operating companies, MetLife Investors USA Insurance Company (which in November 2014 will be merged into a new, larger MetLife subsidiary domiciled in Delaware, MetLife Insurance Company USA). We are also active participants in supervisory colleges of MetLife's regulators, including the most recent one completed in March 2014.

Based on our experience working in the state-based regulatory system and applying that system to MetLife, we believe that SIFI designation is clearly inappropriate if FSOC sufficiently considers two critical aspects of the regulatory system that currently governs MetLife's insurance operations:

- First, state insurance laws require that the assets of each insurance operating company supporting the liabilities of that company be kept separate from the assets and liabilities of all entities in the same holding company structure. In other words, each operating company's assets are "ring fenced" – that is, they are unavailable to pay any liabilities of any of its affiliates. That structure exists from the moment of formation of each insurance operating company and makes it highly unlikely that distress at one of MetLife's insurance operating companies would spread to other companies within the affiliated group as history shows. The state regulatory system's emphasis on insurance operating companies and strict limitations on the movement of capital within the holding company system is one of the system's greatest strengths, providing protection to policyholders and serving as a source of stability in the insurance industry for well over 100 years.

- Second, in addition to controlling the flow of capital among affiliates in an insurance holding company system, state regulators also have supervisory power over the holding company itself, including the right to demand information from the holding company about any issue that might have a material impact on a licensed insurance operating company. In the wake of the 2008 financial crisis, state regulators, working through the National Association of Insurance Commissioners ("NAIC"), further enhanced that power with a requirement that insurance holding companies file an enterprise risk management report with every state that regulates a licensed insurance company, a more formalized supervisory college system and additional annual financial reporting requirements.

- Finally, MetLife's transparent use of captive reinsurance does not weaken the company financially and does not create systemic risk. Captive reinsurance transactions, like any intercompany transaction, must be approved by the state regulators overseeing the ceding company as well as the captive, and captive reinsurers are subject to strict capital and reserving requirements in their states of domicile.

Each of these points is explained in more detail below.

Ring Fencing

Dodd-Frank requires FSOC to consider the effectiveness of existing regulation when deciding whether to designate a nonbank financial institution as a SIFI. Yet from what we understand of FSOC's analysis of MetLife and other potential SIFIs, there seems to be very little analysis of the state-based system of insurance regulation that has served the industry and the country so well for more than 100 years.

One of the great strengths of that state-based system is its focus on insurance operating companies and separating, or "ring fencing", the assets of each company, so that they are available to meet the liabilities of that company, and that company alone. Ring fencing makes it much less likely that insurance companies will fail, and in the rare instances where a regulated company does find itself in distress, ring fencing ensures that the distress does not spread to other entities within an affiliated group and protects assets within the group, which would prove helpful should resolution occur.

In Delaware, a domestic insurance company may not issue dividends to its shareholders without the prior approval of the state insurance commissioner. *See* Delaware Insurance Law § 5005. A domestic insurer also must notify the insurance commissioner of any material transaction with an affiliate, and may not proceed if the commissioner disapproves the transaction. The standards for the commissioner's review of dividends and material affiliate transactions gives the regulator broad discretion to disapprove transactions that include terms that are not "fair and reasonable" or because "the insurer's surplus as regards policyholders following any dividends or distributions to shareholder affiliates" is not "reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs." *See id.* The same or substantially similar standards apply to insurers in every US jurisdiction. State regulators can and do exercise their authority to disapprove dividends and affiliate transactions on a regular basis as part of their supervisory oversight. This authority enables state regulators to discharge their mandate to protect policyholders' interests, which they do by carefully supervising the financial strength of insurance writing companies.

Regulatory oversight of an insurer's ability to move money between affiliates or to "upstream" earnings in the form of dividends is a critical strength of the state-based system. Insurance regulators cannot approve dividends unless the company's balance sheet is strong, and it is clear that the insurer will be able to make good on its insurance promises.

The ring fencing structure of insurance operating companies is particularly important in those rare instances where an insurance company in a group is in distress. Ring-fencing prevents company management (and regulators) from using the assets of healthy companies to shore up a weaker affiliated company in the same group. In the state-based system, transactions between insurance companies and their affiliates often must pass muster with two or more regulators, each focused on the solvency of the licensed operating company for which it is responsible. This process makes it far less likely that financial distress at a single insurance company will spread even to its affiliates, let alone to the financial system at large.

Holding Company Supervision

FSOC's analysis of insurance companies for potential SIFI designation suggests a belief that states lack the authority to supervise insurance holding companies. In fact, states have broad authority to monitor and review the financial health of insurance holding company systems. Every state has adopted an insurance Holding Company Act (the "HCA") which provides state regulators with an array of tools to ensure the solvency of insurance companies and the holding companies systems of which they are a part. Each state's HCA is based on, and substantially similar to, the NAIC Model Holding Company Act, so the authority of each state in regulating insurance holding company systems is uniform across the country.

Under the HCA, every licensed insurer is required to file, and annually update, a registration statement with its domiciliary regulator which details the financial condition of the insurer, identifies agreements or transactions into which the insurer has entered into with holding company affiliates, identifies the management of the insurer and details the relationship with every member of the holding company system. As discussed above, certain agreements with affiliates, including reinsurance agreements, management agreements and extensions of credit, as well as the distribution of extraordinary dividends must be filed with and in many cases approved by state regulators pursuant to the HCA.

State regulators also must approve any change in control of an insurer and, as part of the approval process, review substantial financial information regarding the proposed owners of the insured, up to and including the ultimate controlling parent, as well as biographical and background information of the officers and directors of the proposed owners. In addition, the HCA requires state regulators to conduct regular examinations of insurers, which include affiliate relationships, in order to ascertain the insurer's financial condition. In conducting such examinations, state regulators regularly use outside consultants to assist with the process, enhancing the state's ability to review and monitor insurance holding company systems.

In the wake of the 2008-09 financial crisis, the NAIC Model HCA was amended to expand the reporting requirements of insurance holding company systems. The amendments require the holding company system to file with state insurance departments annual enterprise risk reports that include disclosures of material risks. With respect to examinations, the amendments expand state regulators' power to review the books and records of affiliates of the insurer in the holding company system. Finally, the Model HCA now includes a more formalized process for the formation, funding and conduct of supervisory colleges, which allow various state regulators as well as any federal or international regulators with authority over entities in the holding company system to meet and coordinate their regulatory efforts.

Thus, not only do states have broad authority to regulate insurance holding company systems, states act to enhance their regulatory powers when they identify potential risks within insurance holding company systems.

Captive Reinsurance

FSOC has expressed "concern" over the use of captive reinsurance to manage reserves by companies like MetLife. *See* FSOC Annual Report, 5/7/14. According to FSOC captive reinsurance

> "can add complexity and reduce transparency around the financial condition and potential resolvability of certain life insurance companies. Regulators and rating agencies have noted that the broad use of captive reinsurance by life insurers may result in regulatory capital ratios that potentially understate risk. During times of financial market volatility when reserve and capital levels for some products should increase, an insurance company that uses captive reinsurance may not be required to hold higher reserves and capital. This could

> become a financial stability concern if a large, complex insurance organization were to experience financial distress." *See id.* at 75.

Delaware is home to a significant number of captive reinsurance companies and ranks as the nation's third largest and the world's sixth largest captive insurance domicile. The Delaware Department of Insurance is therefore familiar with these arrangements, and monitors them to ensure that they are not used inappropriately and do not present risk. Based on the reviews we regularly conduct, I am confident that FSOC's concerns are misplaced—and that captive reinsurance arrangements are not a source of risk to the financial system—for at least the following reasons:

- Every captive reinsurance arrangement must be disclosed to and approved by the insurer's domestic state regulator.

- State regulators do not approve captive reinsurance transactions that would reduce reserves to below the actual economic reserves required.

- 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 3 to 5 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. If I as Commissioner deem that additional targeted examinations are necessary, I have and will exercise the authority to conduct such an examination.

- 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.

I believe that captive reinsurance arrangements are an appropriate, fully-disclosed, regulator-approved "release valve" that allows companies to reduce excess reserves and efficiently manage capital. Because captive reinsurance arrangements are closely monitored by state regulators, such arrangements facilitate lower prices and more life insurance capacity without substantially increasing insolvency risk.

Some critics take the view that captive reinsurance arrangements could make an insurer's Risk Based Capital score less reliable and therefore prevent an insurance regulator from intervening appropriately when an insurer is in the early stages of distress. This concern would only be valid, however, if statutory reserves were perfectly aligned with economic reserves, and there is broad agreement that they are not. Moreover, as discussed above, in Delaware the insurance commissioner is required to disapprove inter-affiliate transactions, including captive reinsurance, if they are not "reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs." The standard is the same or substantially similar in all other US states.

Captive reinsurance arrangements have received scrutiny by regulators, rating agencies and other insurance industry associations, including the NAIC, for at least a decade, and in that time there has been no credible evidence that such arrangements significantly increase insolvency risks of insurers that utilize them. In addition, captive reinsurance arrangements normally require regulatory approval from two different regulators (the domiciliary regulator of the ceding insurer as well as the domiciliary regulator of the captive insurer) and require independent actuarial analysis as part of the approval process. Similarly, in the past decade, there has been no indication that captive reinsurance arrangements have produced substantial hidden risks or that the arrangements have been overlooked by regulators or ratings agencies. *See id*; *see also* NAIC, "Captive and Special Purpose Vehicles," June 6, 2013.

The bottom line is that while reserves are lowered through captive reinsurance transactions approved in advance by state regulators, the remaining reserves are still well in excess of economic reserves. Therefore, life insurers are not inappropriately weakened as a result of captive reinsurance arrangements.

Finally, there is no indication that the use of captive reinsurance arrangements creates or adds to systemic risk. State insurance regulators are best positioned to understand proposed captive reinsurance transactions and the overall reserving picture at an insurance company. A state regulator would not approve a transaction of a type or magnitude that would threaten the stability of the insurance company he or she was supervising, much less the financial system as a whole.

Conclusion

Although much of FSOC's work concerning MetLife and other SIFI designations has occurred behind closed doors, it is clear from publicly available information that FSOC has not given sufficient consideration to the strength of the state-based regulatory system, its ability to ring fence the assets of licensed insurers and its supervisory power over insurance holding companies. Meanwhile, FSOC has given too much weight to criticism of captive reinsurance transactions, a practice that is fully disclosed to state insurance regulators and used only with their approval to reduce excess reserves.

In the unlikely event that MetLife or one of its subsidiaries were to fail, state regulators have the experience necessary to ensure an orderly resolution of its insurance subsidiaries (where most assets reside) with the remainder of the firm being resolved through bankruptcy proceedings.

The aforementioned regulatory structures and protections effectively prevent any possibility of systemic risk arising from the activities of an insurance group that, like MetLife conducts the preponderance of its business inside regulated insurance operating subsidiaries. I believe that for these reasons among many others MetLife is not systemically important based on the considerations set forth in Dodd-Frank. I therefore urge FSOC to reconsider its preliminary designation.

Please let me know if you have any questions about any of the issues raised in this letter or any aspect of state insurance regulation. My staff and I would welcome the opportunity to discuss them with you.

Respectfully,

Karen Weldin Stewart, CIR-ML
Delaware Insurance Commissioner

cc: Richard Cordray, Director Consumer Financial Protection Bureau
Thomas J. Curry, Comptroller of the Currency
Martin J. Gruenberg, Chairman Federal Deposit Insurance Corporation
Adam Hamm, Commissioner North Dakota Insurance Department
Timothy G. Massad, Acting Chairman Commodity Futures Trading Commission
Debbie Matz, Chairman National Credit Union Administration
Michael T. McRaith, Director Federal Insurance Office
Melvin L. Watt, Director Federal Housing Finance Agency
Mary Jo White, Chair Securities and Exchange Commission
S. Roy Woodall, Independent Member with Insurance Expertise FSOC
Janet L. Yellen, Chairman Board of Governors of the Federal Reserve System
The Honorable Tom Carper, United States Senator
The Honorable Chris Coons, United States Senator
The Honorable John Carney, Member of Congress
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Gregory M. Redmond, Vice President MetLife