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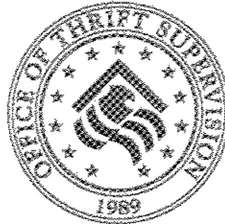

Statement of

Grovetta N. Gardineer
Managing Director for Corporate and International Activities

regarding

Insurance Savings and Loan Holding Companies

before the

Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
United States House of Representatives

March 18, 2010

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W.
Washington, DC 20552
202-906-6288

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I. Introduction

Good morning Chairman Kanjorski, Ranking Member Garrett and distinguished Members of the Subcommittee. Thank you for the opportunity to testify on behalf of the Office of Thrift Supervision (OTS) regarding savings and loan holding companies (SLHCs) engaged predominantly in insurance activities (insurance holding companies).

As Congress continues to consider financial regulatory reform, it is important to understand the scope of OTS's authority to supervise savings and loan insurance holding companies. While the OTS has broad authority to supervise an insurance holding company enterprise, including affiliates and subsidiaries, we think it is prudent to align the regulatory authority with the holding company enterprise's primary activities.

The statutory framework for SLHCs was designed primarily to ensure the safety and soundness of OTS-regulated insured depositories. We believe that the regulatory framework governing insurance holding companies should be amended to provide the functional regulator of the largest activity within a diversified financial company (in this case the insurance regulator) the authority to act as the consolidated holding company regulator. In that instance, the core business program of the company would align with the expertise of the holding company regulator.

My testimony today begins with a discussion of the statutory framework and legislative history of SLHC supervision and how that framework was designed to ensure

the safety and soundness of the depository institution. I will then outline OTS's approach to the supervision of SLHCs that are predominantly insurers, the OTS insurance holding company supervision program and the imperfections of a system where a regulator of a small piece of the overall organization is the only federal regulatory option for consolidated supervision. We also recommend a new regulatory framework that could enhance the oversight of the enterprise-wide health of insurance holding companies.

II. Statutory Language and Legislative History

The statutory approach to SLHCs has always been premised on preserving the safety and soundness of the subsidiary thrift. Congress passed the first SLHC legislation, known as the Spence Act, in 1959.[1] Although largely intended as "stopgap legislation," the Spence Act contained provisions prohibiting savings associations from investing in or in any way having an interest in the securities of the holding company or its subsidiaries.[2] Similarly, savings associations were prohibited from extending credit to their holding companies or their subsidiaries.[3]

Seven years after enactment of the Spence Act, Congress revisited SLHC regulation by enacting the Savings and Loan Holding Company Amendments of 1967[4] which came to be known as the Savings and Loan Holding Company Act (SLHCA).[5] Unlike the Spence Act, which was limited in its scope, the SLHCA provided a comprehensive statutory framework for the registration, examination and regulation of SLHCs. Among other things, this comprehensive law was designed to preserve the safety and soundness of the subsidiary thrift by protecting holding company subsidiary institutions from overreaching by affiliates in a holding company structure. In the Senate Banking Committee hearings for this legislation, Federal Home Loan Bank Board (FHLBB) Chairman Horne noted that with most business enterprises it is of no public concern how a parent company chooses to use its subsidiary, "[b]ut when one of those subsidiaries has the bulk of its liabilities in the form of savings entrusted to it by the public and when those liabilities are insured by a public agency, then there is a very strong reason for public concern over the purposes which that company is made to serve and over dealings of any sort that are not conducted at arm's length."[6]

[1] Pub. L. 86-374, 73 Stat. 691 (1959).
[2] *Id.*
[3] *Id.*
[4] Pub. L. 90-225 (1968).
[5] The SLHCA is now section 10 of the Home Owners' Loan Act. 12 U.S.C. 1467a.
[6] Savings and Loan Holding Companies: Hearings on S. 1542 Before the Senate Committee on Banking and Currency," 90th Cong., 1st Sess. at 27 (1967) (Statement of John E. Horne).

Congress next amended the SLHCA as part of the Competitive Equality Banking Act of 1987 (CEBA).[7] The amendments did not alter the fundamental purpose of the SLHCA—to protect the safety and soundness of the subsidiary thrift.

Two years after the enactment of CEBA, Congress again amended the SLHCA as part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).[8] The FIRREA amendments were premised on preserving the safety and soundness of the subsidiary institution. For example, FIRREA provided the OTS with an expedited enforcement remedy against holding companies whose activities endanger the financial stability or safety and soundness of their subsidiary thrift.[9] Savings institutions were generally made subject to Sections 23A, 23B and 22(h) of the Federal Reserve Act, in the same manner and to the same extent as those sections apply to Federal Reserve member banks.[10]

Ten years after FIRREA, Congress passed the Gramm-Leach-Bliley Act of 1999 (GLBA).[11] As the Subcommittee is well aware, the GLBA facilitates affiliations among banks, securities firms and insurance companies. So long as certain conditions are met, a bank holding company can qualify as a financial company and engage in a wide variety of services that are financial in nature.[12]

In the GLBA Congress instituted special provisions with respect to OTS and the Board of Governors of the Federal Reserve System (Board) supervision of functionally regulated subsidiaries of holding companies, such as insurance companies. Generally, these provisions require coordination with the functional regulator and require the OTS and the Board to predicate certain actions on the safety and soundness of the subsidiary depository institution. GLBA also amended the SLHCA to prohibit new unitary SLHCs from engaging in nonfinancial activities or affiliating with nonfinancial organizations.[13] Existing unitary holding companies were "grandfathered." The restrictions, however, continued to allow financial activities to be conducted by the holding company, to the same extent as a bank holding company, including insurance activities.

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[7] Pub. L. 100-86, 100 Stat. 552 (1987).
[8] Pub. L. 100-73, 103 Stat. 183 (1989).
[9] 12 U.S.C. 1467a(p)(1).
[10] 12 U.S.C. 1468
[11] Pub. L. 106-102, 113 Stat. 1338.
[12] 12 U.S.C. 1843(l)(1).
[13] *Id.* at § 401.

III. OTS Holding Companies Engaged Predominantly In Insurance Operations

OTS supervised insurance holding companies are diverse. They include some of the largest publicly held insurance companies in the United States, large and small mutual insurance companies, privately held companies and fraternal organizations. These holding companies own insurance subsidiaries domiciled in almost every state in our country. These operations offer insurance and banking products to citizens across the United States. Some have insurance operations in foreign countries as well. These holding companies provide products across the various sectors of the insurance industry including life insurance, annuities, title and property and casualty insurance for consumers and businesses of all sizes. Through their savings association subsidiaries they are able to offer a full range of financial products.

Included in the 35 insurance holding companies supervised by OTS are Prudential, Principal, Allstate, State Farm, Nationwide, TIAA-CREF and The Hartford. In addition, OTS regulates holding companies with significant insurance activities that combine securities activities as well, such as Ameriprise. OTS also regulates approximately another 39 holding companies that engage in insurance activities to a lesser degree, but are not considered predominantly insurance companies.

IV. OTS Holding Company Supervision Program

Once a company acquires or charters a thrift institution, as a SLHC it is subject to regulatory examination and monitoring by the OTS. As the primary federal regulator of savings and loan insurance holding companies, the OTS has the authority to examine each insurance holding company, including its subsidiaries subject only to certain obligations under the GLBA to coordinate with the functional regulator[14]. We commonly refer to this overall entity as the holding company enterprise. In its examination and supervision of the enterprise, OTS uses a risk-focused approach that considers the combined risk profile of the holding company, its financial health and stability, and the interdependence of entities within the structure.

The primary objective of a risk-focused examination of an insurance holding company is to identify and examine the areas of the business that pose the greatest degree of risk to the condition of the overall enterprise and to the thrift. The initial scope of the examination targets the areas that have higher than normal risk characteristics. Employing this approach requires examiners to use judgment in determining the level of

[14] Pub.L. 106-102, 113 Stat. 1338.

review, testing and analysis necessary to assess the condition of the enterprise. Accordingly, the scope of each examination is specifically tailored to the risk associated with the enterprise and it is determined on a case-by-case basis. It may also change from year-to-year as OTS sets different areas for targeted review.

The examination goal is consistent across all types of holding company enterprises; however, the level of review and amount of resources needed to assess a complex structure, such as an insurance holding company, is far greater than what would be required for a less complex holding company.

Executing the OTS holding company examination approach for insurance structures can require advanced financial and analytical skills to address the complexity of some of these organizations. Aggregating the risk of individual companies within the structure in order to formulate an evaluation of the overall consolidated risk of the organization requires both expertise and judgment. OTS assigns some of its most experienced examiners to the examination of insurance holding companies. Their extensive grounding in financial regulatory concepts and experience in coordinating and communicating with holding company staff provides the foundation for reviewing the broader scope of activities in a diverse financial company with insurance operations. Still, fully understanding insurance holding companies involves an intensive learning curve as examiners become acclimated to the highly technical concepts of insurance underwriting and reserving, as well as terminology and interaction with functional regulators both domestic and foreign.

Coordination with Other Regulators

Consultation with other regulators is essential to OTS's supervision of SLHCs. OTS seeks to achieve the legislative goal of reducing duplication by sharing information and working closely with other state and federal regulators. In conducting its review of an insurance holding company enterprise, OTS relies on the state insurance regulators for information and findings regarding the entity for which they are functionally responsible. To limit regulatory duplication, OTS has entered into regulatory cooperation agreements with all but two state insurance regulators.

As a first source, OTS examiners use readily available information about an insurance company in the holding company enterprise by obtaining and reviewing reports the company submits to its primary regulator, information that it reports publicly and externally audited financial statements.

OTS may also request examination information directly from the company if the insurance regulator cannot provide it. It is important to note that OTS may only seek information directly from the company if that information meets certain conditions. Specifically, the information can only be requested if it is needed to assess: (1) a material risk to a thrift or holding company; (2) compliance with a federal law that OTS has specific authority to enforce against the functionally-regulated entity, or (3) the systems for monitoring and controlling the financial and operational risks that may threaten the safety and soundness of a thrift.

Examination Components

Examination of holding companies is an important part of OTS's supervisory program. OTS examiners' work assesses the condition of the holding company enterprise and helps ensure that the operations of the holding company do not harm the thrift affiliate.

In carrying out its regulatory function regarding holding companies, the OTS evaluates four components, collectively known by the acronym "CORE."

The "C" in the CORE rating stands for "Capital." In its review of a SLHC's capital adequacy, OTS considers the risk inherent in the enterprise's activities and the ability of capital to absorb unanticipated losses, support the level and composition of debt of the parent company and subsidiaries, and support business plans and strategies.

"O" is for "Organizational Structure." This component involves identifying the organizational structure and ownership, and assessing any changes. This part of the examination also includes an assessment of: (1) lines of business and activities, and the inherent risks they pose; (2) concentrations of risk; and (3) the nature and volume of intra-group transactions and significant intercompany relationships.

"R" represents "Risk Management," which involves the ability of the board and executive management to identify, measure, monitor and control risk within the holding company enterprise. Managing risk is fundamental to the success of any business venture. OTS expects holding companies to have adequate risk management practices, including strong corporate governance and a system of internal controls. Such risk management practices should be commensurate with the size and complexity of the holding company enterprise.

"E" represents "Earnings/Liquidity," which involves the overall financial performance of the consolidated holding company enterprise, including the quality of consolidated earnings, profitability and liquidity. This includes the holding company's

earnings trends and cash flow, as well as the relative contributions and dividend payout ratios of significant subsidiaries, and the current and prospective effect on subsidiaries, including the thrift.

Once OTS examiners have completed their review of the CORE components, they develop a composite rating, which is the overall assessment of the holding company enterprise as reflected by consolidated risk management and consolidated financial strength. Examiners exercise judgment in determining the relative importance of each CORE component to the safe and sound operation of the holding company.

V. Areas for Improvement in the Consolidated Supervision of Insurance Holding Companies

The statutory regime governing SLHCs is premised primarily on preserving the safety and soundness of the subsidiary thrift. Clearly OTS would not have a role in the supervision of an insurance holding company enterprise if not for its relationship with a savings association.

We believe that a holding company that engages predominantly in insurance activities should be regulated by an insurance regulator. While the OTS is effective in coordinating relationships with state insurance regulators, state insurance regulators are in the best position to control and supervise insurance holding companies because insurance is the predominant activity of the enterprise.

Typically, insurance companies come to OTS with established insurance operations and a pre-existing relationship with state insurance regulators. As such, they are unfamiliar with the concept of holding company regulation. As OTS steps into this role it can be awkward to familiarize the company with our involvement beyond the confines of the savings association, especially in cases where the thrift institution is a small part of the company's operations. To address this, OTS can and does include conditions in our application approvals that outline our supervisory expectations.

Furthermore, some provisions of law designed to reduce regulatory burden can impede our ability to address swiftly some supervisory concerns focused primarily on the impact to the subsidiary thrift itself, as opposed to the insurance company subsidiary. For example, with respect to capital adequacy requirements, OTS is prohibited from proscribing such requirements for an insurance company subsidiary.[15] Similarly, OTS

[15] 12 U.S.C. 1844(c)(3); 1831v(a). We note that on December 11, 2009, the House passed H.R. 4173, the Wall Street Reform and Consumer Protection Act, which among other things eliminates this provision and the other provisions discussed in this paragraph. *See*, H.R. 4173, as engrossed, sec. 1303(e).

may not require an insurance company subsidiary of a holding company to provide capital or other funds or assets to a savings association subsidiary of the holding company if the state insurance supervisor determines that such action would have a materially adverse effect on the financial condition of the insurance company.[16] In extreme circumstances, OTS could require divestiture of the thrift institution.[17]

VI. Recommendation for a New Regulatory Structure for Insurance Holding Companies

We recommend that Congress improve the regulatory framework for the consolidated supervision of insurance holding companies. We suggest that the functional regulator of the largest activity within a diversified financial company should be the holding company regulator, with jurisdiction over the holding company and all non-functionally regulated entities. We believe there is significant benefit to housing the supervision of holding companies with the supervisor of the predominant underlying regulated activity. An unintended consequence of functional regulation is that it takes time to coordinate, and additional efforts to ensure consistent treatment.

A holding company regulator should have authority to monitor the activities of the affiliates, to exercise full enforcement authority and to implement information-sharing arrangements between entities in the holding company structure and their functional regulators. The regulator should have the authority to impose capital requirements, restrict activities and otherwise regulate the operations of the holding company and the non-functionally regulated affiliates.

We believe the authority to supervise the entire corporate structure of an insurance holding company could be housed within a federal insurance regulator, if Congress chose to create one. In the absence of the creation of a federal insurance regulator, however, we believe that at a minimum, a federal insurance office should be established with authority over insurance holding companies and non-functionally regulated affiliates.

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[16] 12 U.S.C. 1844(g)(1); 1831v(a).
[17] 12 U.S.C. 1844(g)(3); 1831v(a).

VII. Conclusion

A fundamental requirement for prudent risk management of a holding company is effective oversight and enforcement authority over the entire organization. We appreciate the opportunity to share OTS's recommendations for a stronger framework that would accomplish this for insurance holding companies. We look forward to working with you on these important issues in the future.