The Financial Stability Oversight Council Holds Inaugural Meeting; Proposed Rulemakings on Nonbank Financial Companies and the Volcker Rule Will Impact Insurers

October 13, 2010

Sutherland continues to track the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act). Title I of the Act established the Financial Stability Oversight Council (Council), and the Council has been tasked with three key systemic risk functions: (1) identifying risks to the financial stability of the United States arising from the material financial distress or failure of large, interconnected bank holding companies *or* nonbank financial companies; (2) promoting market discipline, by eliminating expectations that the U.S. government will protect shareholders, creditors, and counterparties from losses in the event of failure of a major institution; and (3) responding to emerging threats to the stability of U.S. financial markets.[1] On October 1, 2010, the Council (as currently comprised) held its initial meeting and took an important first step down the arduous path of rulemaking that will set the standards for nonbank financial companies (NFC(s)), including potentially insurers, that will be subject to the new regulatory regime. As a result of the initial meeting, the Council issued two advance notices of proposed rulemaking regarding: (1) its authority to require supervision and regulation of certain NFCs; and (2) the so-called "Volcker Rule." These rulemakings will provide some initial context on how the Council will impact the operations of insurance companies.

Inaugural Meeting of the Council

There was significant "buzz" both positive and negative prior to the meeting as questions were raised about the ability of the heads of key regulatory agencies to cooperate and collaborate effectively without letting politics or turf wars become roadblocks. While certain key members of the Council were not in attendance because those positions remain vacant, the Council is, nevertheless, moving forward in accordance with the mandate under the Act to meet certain deadlines for implementing the Act through new rules and studies. In attendance at the Council's meeting were eight of the ten voting members that comprise the Council:

- Tim Geithner, Treasury Secretary (Chairperson of the Council);
- Sheila Bair, Chairman of the Federal Deposit Insurance Corporation;
- Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System;
- Edward DeMarco, Acting Director of the Federal Housing Finance Agency;
- Gary Gensler, Chairman of the Commodity Futures Trading Commission;
- Debbie Matz, Chairman of the National Credit Union Administration;
- Mary Schapiro, Chairman of the U.S. Securities and Exchange Commission; and
- John Walsh, Acting Comptroller of the Currency.

[1] For a more complete description of Title I of the Act, see "The Dodd-Frank Act: A New Era of Financial Regulation and the Implications for the Insurance Industry" (Aug. 3, 2010) (Dodd-Frank Legal Alert). Click here to be directed to the Alert.

Two positions that will serve as voting members of the Council have not yet been filled: the Director of the Bureau of Consumer Financial Protection;[2] and the independent member with insurance expertise appointed by the president.

The following three of five non-voting members were in attendance at the initial Council meeting as well:

- William Haraf, Commissioner, California Department of Financial Institutions;
- John Huff, Director, Missouri Department of Insurance, Financial Institutions, and Professional Registration; and
- David Massey, Deputy Securities Administrator, North Carolina Department of the Secretary of State, Securities Division.

Two non-voting members have not yet been appointed: the Director of the Office of Financial Research; and the Director of the Federal Insurance Office.

The inaugural meeting of the Council accomplished basic matters, such as approving the Council's Bylaws, approving its Transparency Policy and establishing an Integrated Implementation Roadmap for the Council setting forth its plan for rulemaking and its independent member agencies. In addition, the initial meeting also provided for the publication of two advanced notices of proposed rulemakings focusing on identifying NFCs that should be subject to heightened oversight and the Volcker Rule.

Rulemaking on Board Supervised NFCs

The Council published a notice in the October 6, 2010, Federal Register on criteria set forth to identify NFCs that pose a risk to the financial stability of the United States.[3] Pursuant to Section 113 of the Act, after the Council has determined that such a risk exists, it has the authority to subject an NFC to the supervision of the Board of Governors of the Federal Reserve System (Board Supervised NFCs) and to impose prudential standards on such company. As described in detail in our earlier Legal Alert assessing the Dodd-Frank Act,[4] insurance companies with or without banking affiliates could be deemed to be Board Supervised NFCs. All Board Supervised NFCs would be subject to the Volcker Rule (see below).

The notice includes fifteen questions regarding the development of a framework for determining which NFCs should be designated for heightened supervision. The questions raised directly correlate to the criteria set forth in the Act for designating such NFCs, and include, among others:

- In assessing an NFC, what are the applicable qualitative and quantitative considerations to measure?
- How should the Council measure and assess the scope, size, and scale of an NFC?
- How should the Council measure and assess the nature, concentration, and mix of activities of an NFC?

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[2] While Elizabeth Warren was selected by President Obama to spearhead efforts to "build" the Bureau of Consumer Financial Protection, she was not technically named as the Director.

[3] 75 Fed. Reg. 61653 (Oct. 6, 2010). Click here to be directed to the Council's request for comments.

[4] See the Dodd-Frank Legal Alert at footnote 1.

- How should the Council measure and assess the leverage and interconnectedness of an NFC?
- How should the Council account for the fact that an NFC is already subject to financial regulation (e.g., state insurance regulation, securities regulation)?
- Should the Council define "material financial distress" or "financial stability"?

In addition, the notice raises questions about how to address programs that were implemented during the financial crisis on a going-forward basis. Comments are due by **November 5, 2010**.

Rulemaking on the Volcker Rule

The Council also issued a notice and request for information regarding the Volcker Rule (Volcker Rule Notice).[5] Section 619 of the Act, commonly referred to as the Volcker Rule, prohibits banking entities (which term includes any affiliate of an insured depository institution) from proprietary trading and from maintaining specified relationships with hedge funds and private equity funds. In addition, subject to rulemaking, the Volcker Rule may impose capital requirements and quantitative limits on those types of activities of Board Supervised NFCs. The Act requires the Council to study and make recommendations by January 22, 2011, on the implementation of the Volcker Rule.

The Volcker Rule notice asks for comments on many difficult issues surrounding the implementation of the rule, some of which will have a direct impact on many insurance companies. First, the Volcker Rule notice asks for comments on how the rule can serve to accommodate the business of insurance within an insurance company, while protecting the safety and soundness of affiliated banking entities (and the U.S. financial system). Second, the notice requests comments on what factors and considerations should inform decisions on "a permitted activity by an insurance company" with respect to both proprietary trading and private equity fund activities (referencing the rule's provision governing permitted activities for the general account of a regulated insurance company). Third, the notice also asks for comments on definitions that will be critical for determining how the Volcker Rule will impact insurance companies and their separate accounts, including the definitions of "trading account," "risk-mitigating hedging activities," and "the purchase, sale, acquisition, disposition of securities or other instruments 'on behalf of customers.'"

Comments on the Volcker Rule are also due on **November 5, 2010.**

We will continue to monitor developments related to the regulatory reform initiatives impacting our insurance company clients.

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If you have any questions about this development, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

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[5] 75 Fed. Reg. 61758 (Oct. 6, 2010). Click here to be directed to the Council's request for comments.

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