

The Financial Stability Oversight Council (Council) approved the attached resolution by notational vote on September 19, 2013, by a vote of seven to two (with the Acting Director of the Federal Housing Finance Agency and the independent member with insurance expertise opposed), except with respect to the first resolution paragraph thereof, appearing on page 5, which the Council approved with nine members voting in favor and none opposed. The Chair of the Securities and Exchange Commission recused herself from the vote.

Dissenting opinions of certain voting and nonvoting members of the Council are also attached hereto.

The basis for the Council's determination is available at www.fsoc.gov.

RESOLUTION APPROVING FINAL DETERMINATION
REGARDING PRUDENTIAL FINANCIAL, INC.

WHEREAS, section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “DFA”) authorizes the Financial Stability Oversight Council (the “Council”) to determine that a nonbank financial company shall be supervised by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and shall be subject to enhanced prudential standards if the Council determines that material financial distress at the nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company, could pose a threat to the financial stability of the United States; and

WHEREAS, in making a determination under section 113 of the DFA, the Council must take into consideration the following: (A) the extent of the leverage of the company; (B) the extent and nature of the off-balance-sheet exposures of the company; (C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies; (D) the importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system; (E) the importance of the company

as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities; (F) the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse; (G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company; (H) the degree to which the company is already regulated by one or more primary financial regulatory agencies; (I) the amount and nature of the financial assets of the company; (J) the amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and (K) any other risk-related factors that the Council deems appropriate; and

WHEREAS, the Council issued a final rule and accompanying interpretive guidance (the “Rule and Guidance”), codified at 12 C.F.R. Part 1310, that describes the criteria and the processes and procedures by which the Council will determine that a nonbank financial company shall be supervised by the Federal Reserve and shall be subject to enhanced prudential standards under the DFA; and

WHEREAS, the Rule and Guidance describes a three-stage process that the Council expects to use for evaluating a nonbank financial company prior to a

Council vote on a proposed determination; and

WHEREAS, the Council has evaluated Prudential Financial, Inc. (“Prudential”), which the Council previously advanced to stage 3, in accordance with the DFA and the Rule and Guidance, including conducting an assessment of all of the considerations set forth in section 113 of the DFA; and

WHEREAS, the Council has considered a broad range of information available through existing public and regulatory sources, as well as information collected directly from Prudential; and

WHEREAS, based on the stage 3 evaluation, the Council made a proposed determination regarding Prudential and provided Prudential written notice of the proposed determination, including an explanation of the basis of the proposed determination; and

WHEREAS, the Council provided Prudential an opportunity to request a hearing before the Council to contest the proposed determination; and

WHEREAS, Prudential requested a written and an oral hearing before the Council;

and

WHEREAS, the Council held a written and an oral hearing in which Prudential contested the proposed determination; and

WHEREAS, based on the evaluation of Prudential, the staffs of the Council Members and of their Agencies recommend that the Council make a final determination regarding Prudential; and

WHEREAS, under the provisions of the DFA and the Rule and Guidance, the Council is required to notify a nonbank financial company of the final determination of the Council, which shall contain a statement of the basis for the decision of the Council; and

WHEREAS, under the provisions of the Rule and Guidance, the Council is required to publicly announce any final determination of the Council under section 113 of the DFA; and

WHEREAS, the members of the Council have considered the issues and the record in connection with the following actions.

NOW, THEREFORE, BE IT RESOLVED, that, to avoid the appearance of any uncertainty regarding certain actions previously taken by the Council, the Council hereby ratifies: (1) the Resolution Approving Publication of the Final Rule and Guidance on Nonbank Financial Company Designations, approved by the Council April 3, 2012; (2) the Resolution Approving the Advancement of a Subset of Nonbank Financial Companies That Were Considered in Stage 2 to Stage 3 of the Evaluation Process, approved by the Council October 18, 2012; (3) the Resolution Approving the Adoption of Amendments to the Hearing Procedures to Govern Hearings Requested by a Nonbank Financial Company, Financial Market Utility, or Financial Institution Engaged in a Payment, Clearing, or Settlement Activity That Is the Subject of a Proposed Determination or Designation, approved by the Council April 4, 2013; (4) the Resolution Approving the Completion of the Evidentiary Record Regarding a Set of Nonbank Financial Companies, approved by the Council May 24, 2013; (5) the Resolution Approving the Proposed Designations of an Initial Set of Nonbank Financial Companies, approved by the Council June 3, 2013; and (6) the Resolution Granting Request for Oral Hearing in Connection with Proposed Determination Regarding Nonbank Financial Company, approved by the Council July 8, 2013.

BE IT FURTHER RESOLVED, that, based on the information, considerations, and analysis set forth in the attached “Basis for the Financial Stability Oversight Council’s Final Determination Regarding Prudential Financial, Inc.” (the “Basis”), and on a review of the administrative record, the Council hereby determines, pursuant to section 102 of the DFA and the Federal Reserve’s Regulation PP, that Prudential is a nonbank financial company and thus eligible for a determination by the Council under section 113 of the DFA.

BE IT FURTHER RESOLVED, that, based on the information, considerations, and analysis set forth in the Basis, and on a review of the administrative record, the Council hereby makes a final determination, pursuant to section 113 of the DFA, that material financial distress at Prudential could pose a threat to the financial stability of the United States and that Prudential shall be supervised by the Federal Reserve and shall be subject to prudential standards, in accordance with Title I of the DFA.

BE IT FURTHER RESOLVED, that the Council has considered and hereby approves the attached “Notice of Final Determination and Statement of the Basis for the Financial Stability Oversight Council’s Final Determination Regarding

Prudential Financial, Inc.” (the “Notice”) and authorizes the Notice to be sent to Prudential.

BE IT FURTHER RESOLVED, that the Council hereby approves the Basis and authorizes the Basis to be released to the public.

BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or his designee, to make technical, nonsubstantive, or conforming changes to the text of the Notice and the Basis.

DISSENTS OF VOTING AND NONVOTING MEMBERS OF THE COUNCIL



Federal Housing Finance Agency

Constitution Center
400 7th Street, S.W.
Washington, D.C. 20024
Telephone: (202) 649-3800
Facsimile: (202) 649-1071
www.fhfa.gov

Views of the Acting Director of the Federal Housing Finance Agency

For the reasons set forth below, I am dissenting from the majority in voting against a final determination to designate Prudential Financial at this time. The analysis in support of the determination demonstrates that under certain circumstances the material financial distress of Prudential Financial could pose a threat to the financial stability of the United States. However, in considering a final determination, my dissenting vote is based on placing greater weight on mitigants to this potential threat, an alternative view of the significance of certain factors, the availability of other tools or methods to address identified risks, and concerns about the consequences of designation, including market impacts. I have concluded that these factors, taken together, warrant refraining from a final determination of this company at this time, with the understanding that the company would remain in Stage 2 and would therefore be subject to continued analysis by the Council in the future. In addition, Prudential has offered to undertake additional actions that would assist the Council in its ongoing analysis of the company, such as developing a resolution plan.

My concerns can be broken down into company-specific issues and broader issues.

Company specific:

The exposure of large financial companies, such as the G-SIFIs, to Prudential is cited as a potential threat to the financial system, despite the acknowledgment that no institution has a disproportionately large exposure to Prudential through financing arrangements. In fact, no large financial institution has more than a de minimus amount of its equity capital exposed to Prudential. While the analysis argues that “in the aggregate” these exposures pose a risk, the alternative view is that this exposure is small on an individual institution basis and broadly spread throughout the financial system, thus limiting the potential for systemic risk.

The analysis of Prudential’s balance sheet leverage does not fully take account of the stability of Prudential’s liabilities, the quality of its assets, or the strength of its equity capital. Prudential has limited market-based funding, its assets are generally high-quality government debt and senior corporate securities, and it lacks the intangible assets that have been a key component of many past failures in the financial services industry. The above characteristics, as well as the company’s limited amount of debt outstanding and a lack of analysis of Prudential’s leverage compared to non-insurance companies, leads to this factor being less significant.

The analysis of risk to Prudential’s derivatives counterparties could be stronger. The analysis does not adequately consider the unique risks and characteristics of Prudential’s derivatives activities—for example, the largest component of Prudential’s derivatives portfolio is interest rate swaps, which (as the analysis acknowledges) lack the same principal and jump-to-default risk as some other derivatives such as credit default swaps. In addition, to fully consider the risks posed by Prudential’s derivatives activities (which are almost entirely hedges) the collateral and the instruments being hedged should be more fully evaluated.

Industry/conceptual issues:

The analysis cites run-risk of Prudential's products as a key catalyst for a destructive asset liquidation. However, insurance products and liabilities are not the same as bank deposit liabilities. A number of existing mitigants are in place to limit run-risk that should be given greater weight when addressing this risk. These include contractual features that allow Prudential to delay payment of early withdrawals while still making regularly scheduled distributions, existing regulatory authorities, and financial disincentives to customers withdrawing funds before maturity. The analysis also cites a risk that a run or temporary halt to early withdrawals at Prudential could lead to runs at other insurance companies without providing supportive evidence that such spillovers are likely. In fact, data shows that industry withdrawals were contained even during the height of the financial crisis of 2007/2008. To the extent that the Council has concerns about the potential for runs on standard products and existing regulatory scrutiny, those concerns would be better addressed by tools other than designation, such as the Council's Section 120 authority.

The analysis also cites stress on the state guaranty system as a cause for concern in a potential failure of Prudential. This could be a potential concern because of the post-funded nature of the system and the lack of any historical precedent failure as large as Prudential. However, these concerns with the guaranty system are an industry issue, not specific to Prudential. As such, to the extent that the Council has concerns regarding the state guaranty system, those concerns could be addressed better through use of the Council's Section 120 authority.

Market impacts:

I am also concerned that without a better understanding of how enhanced supervision will be implemented the designation of Prudential could distort market equilibrium and competition. The effects are unknown at this point but could be magnified by the fact that with the designation of Prudential, only one insurer will be operating under a materially different capital and regulatory regime than all other participants in the market.



Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Date: 9/18/2013

The following is a public version of the dissent of the Council's Independent Member delivered to Council Members.

Views of the Council's Independent Member having Insurance Expertise

As the Financial Stability Oversight Council's (the "Council") Independent Member having insurance expertise, I dissent from the Final Determination of the Council that, based on the analysis and conclusions presented in the Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. ("Basis") and the administrative record, the material financial distress of Prudential Financial, Inc. ("Prudential") could pose a threat to the financial stability of the United States.¹

In making its Final Determination, the Council has adopted the analysis contained in the Basis. Key aspects of said analysis are not supported by the record or actual experience; and, therefore, are not persuasive. The underlying analysis utilizes scenarios that are antithetical to a fundamental and seasoned understanding of the business of insurance, the insurance regulatory environment, and the state insurance company resolution and guaranty fund systems. As presented, therefore, the analysis makes it impossible for me to concur because the grounds for the Final Determination are simply not reasonable or defensible, and provide no basis for me to concur.

Many of my views, as well as those of Director Huff and others, are underscored by arguments presented by Prudential in response to the Council's earlier Proposed Determination analysis. What follows represents the most serious of my major points of disagreement with the rationale for the Final Determination.

Transmission Channels

The Council identified three transmission channels as avenues by which a nonbank financial company could transmit risk of instability to the financial system: (1) exposure; (2) asset liquidation; and (3) critical function or service. The Council has determined that Prudential's material financial distress could pose a threat to financial stability focusing on two of the channels: exposure and asset liquidation.²

¹ The Council has based its conclusion solely on what is referred to as the First Determination Standard; namely: "material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States." *See* Appendix A to Part 1310 – Financial Stability Oversight Council Guidance for Nonbank Financial Company Determinations ("Interpretive Guidance"), 12 C.F.R. pt. 1310, app. A (2013). The Council did not consider Prudential under the "Second Determination Standard," which relates to specific activities of the company, as discussed further below.

² Prudential's share of generally fragmented and competitive markets does not appear large enough to cause a significant disruption in the provision of services should Prudential experience material financial distress and be unable or unwilling to provide such services.

(1) *Exposure Transmission Channel*

The Council’s Interpretive Guidance explains that its consideration of the exposure channel would involve exposures “significant enough to materially impair” creditors, counterparties, investors, or other market participants.³

Neither the Basis nor the administrative record supports the conclusion that the exposure of Prudential’s creditors, counterparties, investors, and other market participants to Prudential are significant enough that Prudential’s material financial distress could *materially impair* those entities and thereby could pose a threat to U.S. financial stability. No specific adverse effect on the financial condition of those other entities is presented to support any conclusion of material impairment. Absent supporting analysis regarding the resulting financial condition of those entities, it is not possible to make such a conclusion.

The Basis does not establish that any individual counterparty would be materially impaired because of losses resulting from exposure to Prudential. Instead, the Basis relies on broader market effects and aggregates the relatively small individual exposures to conclude that exposures across multiple markets and financial products are significant enough that material financial distress at Prudential could contribute to a material impairment in the functioning of key financial markets. Although aggregate exposures are large, individual losses may be able to be absorbed by counterparties or policyholders without materially impairing financial condition, financial services or economic activity.

I do not agree, without further supporting analysis, that relatively small exposures spread among many financial institutions would materially impair these same institutions simply because of broader market effects. Moreover, such a line of reasoning would inevitably lead to a conclusion that any nonbank financial company above a certain size is a threat – contradicting pronouncements that “size alone” is not the test for determination.

The assumed failure of Prudential, both at the holding company level and across *all* of its subsidiaries, would be a significant market event leading to destabilizing and negative effects for individuals, firms, and markets. The Basis reasonably predicts where the relatively small losses would fall. But while losses borne broadly among financial market participants would have a small impact on their capital, the conclusion that these exposures could serve to spread material financial distress at Prudential to counterparties and financial markets more broadly is not supported by the Basis or the administrative record. In addition, the other impacts noted in the Basis regarding potential effects on policyholders, state guaranty funds, or other insurers are not convincing.

³ Interpretive Guidance, 12 C.F.R. pt. 1310, app. A (2013).

(2) *Asset Liquidation Transmission Channel*

The Council's asset liquidation channel hinges on an assumed run by *millions* of life insurance policyholders, who would collectively surrender or withdraw a significant portion of life insurance cash values. In addition to alleging that such withdrawal and surrender requests could strain Prudential's liquidity resources to meet such a run with all of its insurance subsidiaries being rendered insolvent, put into receivership, and liquidated, the Basis postulates that such a run could cause liquidity runs on other life insurers. In addition to a run by life insurance policyholders, the Basis appears to assume that separate account holders, like variable annuity and other contract holders, would also run *en masse*, causing asset liquidations, and that these consequences would lead to financial instability.

The Council's analysis is flawed in several significant respects.

- While there have in fact been liquidity runs on life insurance companies, no historical, quantitative or qualitative evidence exists in the record that supports a run of the scale and speed posited, or to support a rapidly spreading sector-wide run. The asset liquidation analysis appears to assume a contemporaneous run against the general and separate accounts by *millions of* life insurance policyholders and a significant number of annuity and other contract holders of products with cash surrender value – a scale for which there is no precedent, and for which the likelihood is believed by most experts to be extraordinarily low. The Basis provides no support for why such a construct is warranted or reasonable. Other more plausible failure hypotheses could have been used.
- The run behavior assumed in the Basis is a homogenous view of Prudential's policy and contract holders in disregard of important distinctions in behaviors of institutional versus retail customers; customer demographics and domicile; an insured's health; economic, market risk, penalty, tax and substitution disincentives; and product type and design (i.e., terms and conditions). There also appears to be a false perception, contradicted by facts and experience, that policyholders value life insurance only or primarily as cash instruments.
- The First Determination Standard requires that the Council consider Prudential, as the parent holding company, to be in material financial distress, but such distress does not necessarily include the material financial distress of all of its major insurance subsidiaries. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")⁴ does not require the Council to presume an unfathomable and inexplicable simultaneous insolvency and liquidation of all insurance subsidiaries, and to do so confuses failure at the holding company level with failure at the operating insurance entity level. Nevertheless such an approach highlights the fact that the Notice's analysis

⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Pub. L. No. 111-203, 124 Stat. 1376 (2010).

under the First Determination Standard is dependent upon its misplaced assumptions of the simultaneous failure of all of Prudential's insurance subsidiaries and a massive and unprecedented, lightning, bank-style run by a significant number of its cash value policyholders and separate account holders, which apparently is the only circumstance in which the Basis concludes that Prudential could pose a threat to financial stability. I believe that, absent a catastrophic mortality event (which would affect the entire sector and also the whole economy), such a corporate cataclysm could not and would not occur.

- One of the key bases underpinning the Basis is the proposition that a significant portion of U.S. general account cash surrender values would be payable within a very short period of time and that Prudential would be unable to accommodate such a large cash outflow, thereby incentivizing other “runners” from Prudential’s life insurance companies as well as other non-affiliated life insurance companies. The existing built-in fail-safes of insurance and annuity product terms and conditions, and Federal and State regulatory and judicial stay authorities – all combine to impede the transmission and slow the potential asset liquidation to a point that it could be managed by Prudential. The Basis rightly notes that any asset liquidation could be slowed by certain mitigating factors, such as Prudential deferring payouts on a significant portion of the immediately payable cash surrender values or the imposition of stays on withdrawals and surrender by state courts. The Basis contends though that these tools could affect market confidence in the life insurance sector as a whole, and possibly trigger surrenders and withdrawals at other insurers. Even assuming *arguendo* that such fail-safes might perhaps lead to other negative effects,⁵ the alleged threat to financial stability from a feared rapid asset liquidation can be countered.
- Runs from separate accounts and asset management accounts are indistinguishable from a market perspective. Therefore, it is difficult to reconcile the Basis’s analysis of assumed runs and forced asset liquidation tied to separate account products and its skepticism as to the sale or transfer of whole companies or blocks of such business, with its different conclusions as to a possible reputational run, asset liquidation, and transfers of Prudential’s asset management business.
- The Basis does not give enough weight to mitigants and appears to question both the professional judgments of regulators to intervene and the effectiveness of stays to stop runs. Such reasoning suggests a misled and partial or incomplete understanding of state-based insurance regulatory system guided by mandatory interventions under State risk-based capital laws. In fact, not only the U.S. State insurance regulators, but also the

⁵ It is also equally plausible that the use of such existing fail-safes might engender greater confidence in the protections afforded insurance consumers and in the regulatory system, and thereby result in long-term positive effects.

Securities and Exchange Commission (“SEC”),⁶ and Japan’s Financial Services Agency, all have the authority to impose early stays. These stays would almost certainly stop any runs and halt the resulting asset liquidations that the Basis indicates would lead to severe impairments of financial intermediation or financial market functioning that would significantly damage the economy.

- Having already contemplated Prudential and its insurance subsidiaries to be in material financial distress, insolvent, and in liquidation, the Basis’s analysis becomes distracted by certain solvency issues, such as captive reinsurance.⁷
- The Basis’s reliance on the lack of a precedent for a failure of an insurance company the size and scale of Prudential begs the question. The question that should be asked is why there has been no such precedent? It seems inherently unreasonable to make negative inferences about the current state resolution and guaranty systems based on the lack of such precedent, while presuming material financial distress and the failure across all insurance subsidiaries; without a reasonable and complete assessment of the extremely low probability of such a scenario occurring. Even though Prudential does not currently have a consolidated regulator, there are many U.S. and non-U.S. regulators overseeing Prudential’s operating entities. That there is “no precedent” is, in large part, a testament to the proven results of State insurance regulators, individually and collectively working through the National Association of Insurance Commissioners (“NAIC”), in strengthening the quality, depth and sophistication of the State regulatory framework for its legal entity supervision, particularly over the last two decades.⁸
- The Basis also does not give sufficient credence to the ability of the state resolution and guaranty systems to serve as a mitigant.

⁶ Section 22(e) of the Investment Company Act prohibits suspension of redemptions and provides a seven-day window for payment of proceeds. However, Section 22(e)(2), and (3) provide authority for the SEC to grant relief from the statute, through rulemaking or an exemptive order.

⁷ Use of affiliated captive reinsurance by life insurers is a notable trend and State insurance regulators face serious challenges in reaching a consensus approach to reform. I favor the Council making recommendations to the primary financial regulators and the Board with respect to capital treatment on a consolidated basis. However, for purposes of the analysis at hand, captive reinsurance has only limited relevance as a potential amplifier of loss exposure to counterparties given the arbitrage of capital quality, but which the analysis does not quantify. Captive reinsurance would be more relevant to the analysis had the Council relied on credit risk to cedent affiliates as a basis in modeling which insurance subsidiaries might become distressed or insolvent, leading to a more plausible scenario of transmission through the resolution and the guaranty systems. However, under the analysis, the insolvency and failure of all insurance subsidiaries is presumed, making issues of affiliate risk and capital transfer less important.

⁸ Moreover, the Basis’s analysis confuses material financial distress at the holding company level with distress at the operating entity level. Prudential is a diversified financial conglomerate, not an operating insurer.

Significant Damage to the Broader Economy

The Basis and the administrative record lack any analysis as to how Prudential's material financial distress would lead to a threat where "there would be an impairment of financial intermediation or financial market functioning that would be sufficiently severe to inflict *significant damage on the broader economy*."⁹ The Basis does not contain any analysis that presents any findings as to severe impairment of financial intermediation; severe impairment of the functioning of U.S. and global financial markets; or resulting significant damage to the economy. No empirical evidence is presented; no data is reviewed; no models are put forward. There is simply no support to link Prudential's material financial distress to *severe* consequences to markets leading to *significant* economic damage.

Conclusion

In view of my disagreement with the rationale in the Basis concerning the major areas discussed above, I respectfully dissent from the Council's Final Determination. I also have other reservations and concerns, as set forth below.

Other Reservations and Concerns

In addition to the dissent from the Final Determination discussed above, several other matters have also weighed heavily on my consideration of this determination.

(1) First and Second Determination Standards

After including extensive review of the profile of Prudential and its activities under the First Determination Standard, the Council decided to not evaluate Prudential under the Second Determination Standard. Given the questionable and unreasonable basis for the Council's reliance solely on the First Determination Standard, it is my position that it would have been prudent for the Council also to have considered the Second Determination Standard pertaining to activities.

This absence from the analysis is regrettable, as much of the public discussion and the focus of regulators (domestic and international), policymakers, academics, and industry participants has been on activities. As a result, the Council's decision to designate Prudential will provide no direction, clarity or transparency to the public or to State insurance regulators, international supervisors, or Prudential itself, as to what activities need to be addressed or modified. The Council fails to make any recommendation to the primary financial regulatory agencies¹⁰ or the Federal Reserve Board of Governors ("Board of Governors"), as anticipated (and provided for) in Dodd-Frank as well as in the Council's own Interpretive Guidance.¹¹ The analysis should

⁹ Interpretive Guidance, 12 C.F.R. pt. 1310, app. A (2013) (emphasis added).

¹⁰ Dodd-Frank §112(k), 12 U.S.C. §5322(k).

¹¹ Interpretive Guidance, 12 C.F.R. pt. 1310, app. A (2013).

have identified any risky or disfavored activities conducted by Prudential; and, in so doing, the Council would have provided needed and useful guidance to inform on-going domestic and international efforts to strengthen the stability of the insurance sector and the financial system as a whole.

(2) *The Collins Amendment*

A determination by the Council that Prudential could pose a threat to financial stability is a prerequisite to its determination whether to subject the company to supervision by the Board of Governors. A plain reading of Section 113 of Dodd-Frank sets out a two-part determination process whereby:

1. “*if the council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States[;]*”
2. “[it] *may determine that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title[.]*”¹²

The penultimate question is whether to subject Prudential to Board of Governors supervision, which is a significant regulatory action. Irrespective of the separate determination as to whether the company could pose a threat to financial stability, I believe that the Council should exercise its discretion and defer a Final Determination as to whether Prudential should be supervised by the Board of Governors and subject to enhanced prudential standards at this time.

The Council’s Final Determination will subject the company to a new supervisory and capital regime.¹³ However, the Basis is silent as to any possible alternative considerations.

It is critical that more consideration be given to the regulatory capital regime that would be imposed on Prudential or any consolidated organization predominated by insurance companies under Board of Governors supervision, especially minimum capital requirements pursuant to section 171 of the Dodd-Frank (commonly referred to as the “Collins Amendment”). The Council’s Final Determination that Prudential should be supervised by the Board of Governors will ultimately lead to the imposition of requirements that are by all indications ill-suited for

¹² Dodd-Frank §113(a)(1), 12 U.S.C. §5323(a)(1) (emphasis added).

¹³ I am not advocating for lower capital requirements. In some circumstances higher capital requirements may be necessary. But I am in favor of capital requirements that are appropriate and that make sense.

insurance companies; and when, unfortunately, the Board of Governors may be constrained in tailoring.¹⁴

It is generally conceded that the Collins Amendment's requirements could potentially have a significant impact on Prudential. The possible unintended negative consequences to consumers, the insurance marketplace, and the broader economy are not at all clear at this point. The competitive disadvantage for Prudential relative to other peers remains a concern.

Time is not of the essence in this case, for Prudential is not in financial distress, material or otherwise. There is no suggestion that it poses an actual threat to U.S. financial stability.¹⁵ There are no exigent (emergency) circumstances,¹⁶ and no specific threatening activities have been identified.

In light of this, the Council should actually refrain from making a final determination and should instead employ other tools or methods at its disposal to address risks, such as subjecting Prudential to on-going, heightened monitoring. The Council could then use this additional time to consider making recommendations to the Board of Governors as to the Collins Amendment.¹⁷ In addition, the Council should make recommendations to Congress pertaining to the Collins Amendment, including any needed legislation.

(3) *Systematic Risk versus Idiosyncratic Risk to the System*

The Basis is also flawed in its approach to overall systematic risk that could apparently be triggered *via* the state-based resolution and guaranty systems by other large life insurance companies – not just Prudential. It should be recognized that the Board of Governors, as consolidated regulator, has no authority under Dodd-Frank Section 165 to address systemic risk presented by any perceived flaws in state resolution processes or state guaranty funds (absent the guaranty funds themselves being designated).¹⁸ To the contrary, state-based resolution of insurance companies and guarantee protections are preserved, as is, in Title 2 of Dodd-Frank.¹⁹ Yet in spite of its apparent concerns, the Council has taken no other action, nor made or tabled for consideration any recommendations to the primary financial regulators, the States, or Congress as to the state resolution and guaranty systems.

¹⁴ The Board of Governors has authority under section 165 to tailor the application of the standards, including differentiating among covered companies on an individual basis or by category. *See* Dodd-Frank §165(a)(2)(A), 12 U.S.C. §5356(a)(2)(A). However, this does not address the potential restraint on the Board of Governors in tailoring those standards due to the Collins Amendment.

¹⁵ Dodd-Frank §121, 12 U.S.C. §5331.

¹⁶ Dodd-Frank §113(f), 12 U.S.C. §5323(f).

¹⁷ Dodd-Frank §§115(a)(2), 112(2)(I), 12 U.S.C. §§5325(a)(2), 5322(2)(I).

¹⁸ The state guaranty funds themselves could possibly qualify as nonbank financial companies eligible for designation.

¹⁹ Dodd-Frank §203(e), 12 U.S.C. §5383(e).

(4) *Recent Regulatory Scrutiny by the Global Insurance Regulators, Finance Ministers, and Central Bankers*

The Basis omits any mention of recent international regulatory scrutiny of Prudential. On July 18, 2013, the Financial Stability Board (“FSB”) announced that, in consultation with the IAIS and “national authorities,” the FSB had identified an initial list of nine global systemically important insurers (“G-SIIs”).²⁰ The FSB list identified Prudential as a G-SII. It appears that the U.S. “national authority” apparently assented to the FSB designation of Prudential as a G-SII – even prior to Prudential’s evidentiary hearing before the Council on its Proposed Determination and to any final decision by the Council.²¹ It seems reasonable to conclude from the spirit and intent of Dodd-Frank that the Council is the primary national authority in the U.S. responsible for financial stability and designating systemically important companies.

Although not binding on the Council’s decision, the declaration of Prudential as a G-SII by the FSB based on the assessment by the U.S. and global insurance regulators, supervisors, and others who are members of the IAIS,²² has overtaken the Council’s own determination process. While the FSB’s action should have no influence, I have come to be concerned that the international and domestic processes may not be entirely separate and distinct, especially where the FSB pronouncements of policy measures to be imposed on the G-SIIs, including Prudential, can only be achieved in the U.S. through a subsequent Council designation.²³ Thus, the action by the FSB interjects a new consideration for me to weigh in that the failure of the Council in not designating Prudential could be viewed to be a failure of the U.S. to comply with decisions made within the G-20.

In considering these new international issues, I am at a disadvantage, particularly in not being privy to the deliberations, insights and results of the methodological assessment of the IAIS and its members, which developed the underlying basis for the FSB’s action, in spite of the Council’s information-sharing Memorandum of Understanding.

²⁰ The FSB is currently working to identify global systemically important financial institutions (“G-SIFIs”) in furtherance of the financial regulatory reform agenda of the Group of Twenty Finance Ministers and Central Bank Governors (“G-20”). G-SIFIs are defined by the FSB as “institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries;” and G-SIIs are one class of SIFIs.

²¹ The FSB also designated MetLife, Inc. as a G-SII, without even a proposed determination by the Council.

²² There are several members of the IAIS from the United States: the individual State insurance commissioners, including the Missouri Director of Insurance, Financial Institutions, and Professional Registration, John Huff; the NAIC; and Treasury’s Federal Insurance Office, whose director is Michael McRaith.

²³ FSB, Press Release: “FSB identifies an initial list of global systemically important insurers (G-SIIs)” (July 18, 2013) (“For the institutions identified today, implementation of enhanced group-wide supervision commences immediately”); *See also* FSB, “Global systemically important insurers (G-SIIs) and the policy measures that will apply to them” at ¶¶4, 7.

View of Director John Huff, the State Insurance Commissioner Representative

I do not believe that there is a sufficient basis for the Council's final determination that Prudential's material financial distress could pose a threat to the financial stability of the United States. In particular, there appears to be a lack of recognition given to the nature of the insurance business and the authorities and tools available to insurance regulators. Insurance is not the same as a banking product yet the Statement of the Basis for the Council's Final Determination (the "Basis") inappropriately applies bank-like concepts to insurance products and their regulation, rendering the rationale for designation flawed, insufficient, and unsupported. Consumers purchase insurance primarily to indemnify against a contingent event, protect against property loss or damage, replace the loss of income in the event of death or disability, and provide stable retirement income. Indeed, consumers seek insurance as a source of stability even in times of economic stress and the authorities of insurance regulators have long protected insurance consumers in difficult times such as the Great Depression and the recent financial crisis. For these and the following reasons, the analysis continues to be insufficient in several key respects:

- 1) The Basis identifies the asset liquidation channel as a primary concern regarding Prudential's potential threat to U.S. financial stability yet it offers merely speculative outcomes related to the liquidation of assets that are not supported by a sufficient understanding of the heterogeneity of insurance products or insurer asset disposition. There is little analysis linking realistic but severe liability run scenarios to readily available liquidity, liquidity obtained through asset sales, and the impact of such asset sales on financial markets. Without such analysis, it is difficult to attach any credibility to the conclusions in the Basis.

The Basis discusses liabilities with certain withdrawal characteristics, presuming that a large majority of Prudential's policyholders would exercise withdrawal rights as depositors to a bank might. It suggests that a significant amount of Prudential's liabilities would be subject to policyholder surrender and payout, but summarily dismisses scenarios more supportable by the evidentiary record involving much lower amounts. In doing so, the Basis does not give sufficient weight to contractual provisions that allow Prudential to manage a significant amount of the potential withdrawals over a lengthy period of time and the ability of regulators to impose additional stays on surrenders. Rather, the Basis merely speculates, without any evidence, that the imposition of stays or contractual deferrals of surrenders would undermine confidence in insurance markets to such a degree that it would threaten the financial stability of the United States.

In fact, all of these scenarios are highly unlikely as they effectively assume that all policyholders eligible to surrender their policies will do so despite the significant

disincentives to policyholder withdrawals including federal income tax liability, federal income tax penalties, surrender penalties, and the loss of guarantees., which the Basis gives little weight. The Basis also asserts that policyholders, in deciding whether to surrender, would consider the amount of the death or retirement benefit as a less important consideration than the cash surrender value, which is much lower than the death benefit. It further argues that the more appropriate comparison would be between the cash surrender value and the “associated liabilities” (i.e., the reserve), explaining that the comparison to the death benefit does not take into account the time value of money or the payments policyholders would continue to make. This is simply incorrect. In making any decision to surrender an insurance policy, policyholders would not know the reserve amount of their policy (which requires an actuarial calculation to determine) and would instead consider the reason they purchased the policy, the death or retirement benefit. In light of this, it is beyond comprehension how policyholders would be able to or even why they would desire to make any other comparison except as between the cash surrender value and the death or retirement benefit. Most policyholders do not view their insurance policies as checking accounts, or even as typical investment accounts. Policyholders pay premiums to obtain the protection insurance provides.

The Basis also fails to demonstrate that the potential extent of the assets required to be liquidated to pay policyholder surrenders under such scenarios would be significant enough to pose a threat to the financial stability of the United States. In this context, the Basis does not give appropriate weight to evidence demonstrating that Prudential’s holdings do not comprise a disproportionately large share of any asset market.

- 2) The exposure channel analysis is not a compelling basis for the final determination as it does not set forth sufficient evidence to conclude that Prudential’s exposures to different counterparties are significant enough to pose a threat to the financial stability of the United States. The Basis also does not adequately analyze actions taken by Prudential’s counterparties, which include several of the largest U.S. banks, or their regulators, which include several of my fellow Council members, to manage the risks arising from transactions with Prudential or other financial counterparties. In attempting to address the fact that individual exposures would not have a systemic impact, the Basis aggregates exposures and argues that together such exposures could pose a threat to the financial system of the United States. In so doing, the Basis merely demonstrates that Prudential is a large insurance company, yet it has been a long accepted principle of this process that size alone is not a sufficient basis for designation.

With respect to exposures to policyholders, the Council does not set forth a reasonable basis to conclude that the financial stability of the United States would be threatened if policyholders were unable to access cash surrender values or suffered losses in the event of Prudential's material financial distress. Accordingly, reliance on such scenarios is inappropriate. It also overstates the guaranty fund's importance to the analysis and does not sufficiently support the apparent conclusion that the impact of Prudential's failure on the guaranty fund system could pose a threat to the financial stability of the United States.

- 3) Some of the statements and arguments in the Basis suggest a lack of appreciation of the operation of the state-based regulatory framework, particularly its resolution processes. The Basis states that the authority of an insurance regulator to ring-fence the insurance legal entity could complicate resolution and could pose a threat to financial stability. Ring-fencing is a powerful regulatory tool utilized by insurance regulators to protect policyholders. In fact, ring-fencing augments financial stability by providing policyholders with the confidence that their policies will be honored, thereby reducing the likelihood and amount of policyholder surrenders as well as decreasing asset liquidation risk. Moreover, ring-fencing does not necessarily prevent a transfer of assets; rather it prevents the transfer of assets without regulatory approval. Accordingly, regulators—U.S. and international—can use this tool to ensure assets remain with the firm long enough to assess liabilities and determine the most appropriate approach to resolving the firm.

In addition, while Prudential may be a complex organization as suggested by the Basis, it is not clear how that complexity translates into a threat to the financial stability of the United States as defined in the Council's rule and guidance, as the analysis does not properly take into account key elements of the insurance resolution process. Insurance regulators have a history of working together in judicially overseen and orderly resolutions.

- 4) The Basis also mischaracterizes, does not sufficiently consider, or otherwise ignores other regulatory authorities and tools. These authorities and tools include, but are not limited to, the ability to take over the company by placing it in administrative supervision or declaring it to be in hazardous financial condition, regulatory risk-based capital triggers, and the ability to stop or slow surrenders. In the event of Prudential's material financial distress or failure, insurance regulators have the authority to take action to minimize the impact that Prudential's failure would have on policyholders and counterparties. Given that one of the primary concerns is policyholder surrenders and the resulting asset liquidation, the ability of regulators to intervene to manage such surrenders is a critical component to any such analysis and should be given more recognition. Instead, the Basis speculates that the use of stays

or similar powers would undermine confidence in the insurance industry but provides no evidence to support that conclusion.

- 5) The Council indicated in its rule and guidance that it will consider a firm's material financial distress to be a threat to financial stability if there would be impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy. While there are conclusory statements in this regard throughout the Basis, there is insufficient analysis to support application of such statements to Prudential.
- 6) The Council also indicated in its rule and guidance that its determination will be made on a firm-specific basis. However, the Basis includes arguments that I do not believe meet that standard, such as concerns regarding state guaranty fund capacity and implicit application of such severe macroeconomic stress that it is unclear whether Prudential is even causing or amplifying the stress in question. Further, these arguments are presented with no limiting principle, which raises concerns that broad industry or macroeconomic related issues, rather than firm-specific issues, could subject a company to designation.

In conclusion, the designation of insurance companies that could pose a threat to the financial stability of the United States is a serious exercise, the result of which could have significant implications for 1) the stability of the financial system, 2) policyholders that may be disadvantaged to the benefit of financial counterparties, 3) the cost and availability of insurance products, and 4) the competitiveness of the insurance sector. It is critically important that these decisions are based on robust analytics and a thorough understanding of the insurance business and insurance regulation. The analysis contained in the basis for the final determination in large part relies on nothing more than speculation. It gives little weight, if any, to evidence in the record, the historical experience of the insurance sector, and the expertise and experience of insurance regulators and, in particular, my colleagues in the states of New Jersey, Connecticut, and Arizona that are primarily responsible for regulating Prudential.

For these reasons, I do not believe that the Council has a sufficient basis to conclude that Prudential's material financial distress could pose a threat to the financial stability of the United States.