Regulating Insurance Companies and the FSOC Designation of SIFIs

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As the financial sector has become more interconnected, and financial activities and functions have become more blurred across institutional forms, the question arises whether insurance companies need federal supervision and, in particular, enhanced supervision due to systemic risk creation. To this point, while the financial crisis of 2007-2009 was very much a banking (or "shadow banking") crisis, insurance companies played their role too.

While the Dodd-Frank Act did not create a new direct regulator of insurance, it did impose a new form of regulation for those nonbank holding companies deemed systemically important financial institutions (SIFIs) by the Financial Stability Oversight Council (FSOC). Dodd-Frank also created a Federal Insurance Office (FIO) whose mandate is to investigate and represent the insurance industry and to refer any regulatory problems that it identifies to other regulators. The CHOICE Act proposes to combine the roles of the FIO director and FSOC Independent Member with Insurance Expertise, with which we agree, and to repeal FSOC's authority to designate nonbanks as SIFIs, with which we do not agree.

In this essay, we examine the degree to which a large, modern insurance company may or may not fit into the SIFI designation, along with the rationale for repealing the FSOC's designation authority. Due to product innovation (and in particular variable annuities) and new risk management tools (such as shadow insurance, securities lending, and derivatives) insurance companies are potentially more exposed to aggregate capital market risks than traditional life insurance companies. Modern insurance companies, many of them being global firms, call for some form of Federal oversight. The failure of a large insurance company could have systemic consequences and can result in large welfare losses if households no longer trust the insurance sector.