Regulatory Alert

Financial Services Regulatory Insight Center

Treasury Report on the Asset Management and Insurance Industries

Closely following the release of its second report on the U.S. financial services regulatory framework, the Department of the Treasury released a report on the asset management and insurance industries, providing recommendations that highlight systemic risk and financial stability, and suggesting that designations of systemic importance for entities in these industries should be based on their activities and not solely on their size. The report is the third in a planned series of four reports analyzing the U.S. financial services regulatory framework and critically reviewing laws, treaties, regulations, guidance, reporting and recordkeeping requirements, and other government policies with an eye to recommending reforms that would align regulatory requirements with the "Core Principles for Regulating the U.S. Financial System."

Recommendations

The recommendations in Treasury's report on asset management and insurance are primarily directed toward the Securities and Exchange Commission (SEC) and the various state and federal insurance regulators. Of the sixty-one recommendations, only four would require Congressional action. Highlights of the recommendations include:

- **Evaluating systemic risk based on** an entity's **products and activities** and not generally on its size as well as **focusing regulatory activity on** those **areas of higher-risk**. This recommendation applies to both the asset management and insurance industries and may signal the end to designations of nonbank systemically important financial institutions (SIFIs). The Financial Stability Oversight Council (FSOC) and the Financial Stability Board have each been considering evaluating asset managers for designation as nonbank SIFIs; only one of the three insurance companies previously designated by the FSOC remains subject to oversight. Treasury is expected to soon release a separate report on the FSOC, including its designation authority. A separate recommendation suggests the U.S federal agencies and the Federal Insurance Office (FIO) promote the recommended "activities-based" approach among the international standards setting bodies for assessments of global systemically important entities in the asset management and insurance industries.
- **Increasing coordination** between the **SEC and** the Commodity Futures Trading Commission (**CFTC**) by **exempting certain investment advisers** registered with the SEC **from dual registration and regulation** with the CFTC (a continuation of the harmonization suggested in the Capital Markets Report.) The

SEC and CFTC are encouraged to work together to identify a single regulator for affected entities – though this may prove difficult to accomplish as it would likely require each of the agencies to relinquish control over certain areas.

— **Delaying full implementation of the Department of Labor's (DOL) Fiduciary Rule** and recommending DOL and the SEC work together to establish standards of conduct, and with state insurance regulators regarding the annuities markets. Notably, DOL has sent a final rule to the Office of Management and Budget to impose an 18-month delay on the final phase of the rule's implementation; SEC Chairman Jay Clayton has acknowledged that SEC is working on a fiduciary rule proposal and has testified that SEC and DOL are "engaging expeditiously and constructively...to best serve the interests of investors." DOL is currently reassessing the impact of its Fiduciary Rule on the ability of investors to access retirement information and financial advice.

— **Targeting specific rulemakings**, such as i) repealing the stress testing requirement for investment advisers, ii) adopting a principles-based approach to liquidity risk management and associated bucketing requirements (which recognizes the differences between funds and banks), iii) moving forward with a "plain-vanilla" exchange traded funds rule (improving investor choice), and iv) withdrawing the SEC proposal on business continuity and transition planning (in favor of the existing principles-based approach).

— **Encouraging ongoing work** by the state insurance regulators, the National Association of Insurance Commissioners (NAIC) and the Federal Reserve Board **to establish insurance group capital and liquidity risk management standards**. The state insurance regulators are also encouraged to adopt and implement the NAIC's Data Security Model Law to establish uniform data security regulations across the country. Under its own initiative, Treasury is taking steps to realign the operations of the FIO to represent and promote the state-based insurance system both domestically and internationally, and to coordinate communication and policy development among federal and state agencies with regard to insurance issues.

— **Introducing legislation** to: revise the definition of "banking entity" for purposes of the Volcker Rule; clarify the "business of insurance" exception applicable to the Consumer Financial Protection Bureau; and establish insurance specific data breach notification requirements in the absence of a uniform state laws.

Closing Thoughts

Financial services regulatory reform was initially outlined by the Financial CHOICE Act, which passed the House of Representatives in June 2017 but has stalled in the Senate. Lacking the necessary bi-partisan support, it is unlikely that the many reforms proposed in this legislation will pass as part of a comprehensive package. In its three reports to date, Treasury has crafted recommendations that rely primarily on agency actions rather than legislation, greatly increasing the prospects for effecting change. It is notable that across all three reports, a number of the recommendations have already been initiated or endorsed by individual agencies, and this pace may increase as agency leadership positions are successfully filled. Accomplishing change within the insurance industry may prove to be a higher hurdle as many of the recommendations will require achieving agreement among the fifty states which, even if all were willing to coordinate, would be difficult based simply on the number of participants.

Treasury will complete its analysis of the financial services regulatory framework with the release of its fourth report, which will address nonbank financial institutions, financial technology, and financial innovation. The report was projected to be released in the fourth quarter of 2017. Separate reports on the FSOC and its authority to designate nonbank SIFIs and the Orderly Liquidation Authority established by Dodd-Frank are forthcoming as well.

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