Financial Services and E-Commerce

The Troubled Asset Relief Program and Insurers

*By Laura Kotelman**

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (EESA) established the Troubled Asset Relief Program (TARP) in an effort to restore liquidity and stability to the U.S. financial system. Under the program, the Secretary of the Treasury, acting through a newly created Office of Financial Stability, is authorized to purchase "troubled assets" from "any financial institution." Troubled assets are defined as "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages," originated or issued on or before March 14, 2008, and "any other financial instruments that the Secretary… determines the purchase of which is necessary to promote financial market stability. Under this Capital Purchase Program (CPP), the Secretary may purchase troubled assets of any financial institution established and regulated in the U.S.

Some insurers are buying savings-and-loan companies to become eligible for the bailout, which was initially targeted at banks and similar financial institutions. Treasury clarified that insurers are qualified to participate in the CPP, provided they are or apply to become federally regulated as holding companies of banks or thrifts. According to the American Council of Life Insurers (ACLI), approximately 48% of life insurance assets are attributable to companies organized as bank or thrift holding companies. On November 14, 2008, four insurance organizations applied to the Office of Thrift Supervision to become thrift holding companies by acquiring savings and loans, setting the stage to become qualified to participate in the CPP.

In recent months, life and property and casualty insurers have taken a big hit from turmoil in the bond markets, where much of their cash is invested. In the third quarter, the industry took tens of billions of dollars of realized and unrealized losses. The risk to the overall economy of big life insurers running low on capital if the market continues to deteriorate may make government assistance necessary—although it is unclear whether the insurers will receive funding. Only $15 billion remains unallocated from the initial $350 billion authorized by Congress. The December 9 list of recipients released by Treasury did not include any of the insurers. It has not requested the remaining $350 billion, which Congress could refuse to release.

Life Insurers

Life Insurers are generally more exposed to distressed and/or illiquid assets and mortgage-backed securities than are P&C insurers. Nevertheless, New York Life, in a press release dated November 6, 2008 stated it would not participate in the CPP. "We are well capitalized with more capital than is required to maintain our triple-A ratings." MassMutual stated in a press release on November 7, 2008, "[O]ur mutual company structure enables us to manage with the long-term interests of our policyholders and customers in mind. Thus, we have not participated in any discussion directly with the Treasury, and we have no intention of participating in the [CPP]." However, in December, Prudential Financial Inc. announced that would seek an unspecified amount of aid through TARP.

Reacting to EESA, Frank Keating, the president and chief executive of the American Council of Life Insurers, said, "If the U.S. government is going to intervene to provide liquidity to the nation's economy, then... the life-insurance industry should be on an even plane" with other financial-services industries. His letter to editor of *The Wall Street Journal* on November 12, 2008 stated that

> Congress explicitly included insurers in the legislation establishing the Troubled Asset Relief Program…. Inclusion of [life insurers that are not eligible as bank or thrift holding companies would be] a reflection of the systemic role they play in the nation's credit markets…. Life insurers are the largest source of bond financing for America's corporations. They provide $2.5 trillion in liquidity to the economy. Thousands of businesses and millions of jobs depend on this financing. Insurers provide another $2.5 trillion in capital to the economy through investments in commercial mortgages, government bonds, and equities…. The nation's economic turmoil has forced life insurers to conserve their capital rather than invest it. As a result, much of the approximately $600 billion insurers will receive in annual premium income won't be flowing through the economy. This represents a major clog in the credit delivery system…. Life insurance companies that choose to participate in the Capital Purchase Program will quickly deploy funding to further the growth and development of American companies and help to restore liquidity and stability to the financial system of the U.S.

Property and Casualty Insurers

Property and casualty insurers are singing a different tune. The American Insurance Association (AIA) stated in a press release dated October 27, 2008.

> We have surveyed our Board of Directors and the substantial majority of the insurers represented by AIA do not support the inclusion of property-casualty insurers in Treasury's Capital Purchase Program. If made available, they will not elect to participate. Those members believe that, as property-casualty insurance writers, they are well-capitalized and well-positioned to weather the current financial market crisis without the assistance of the CPP announced by Treasury. As a result, the property-casualty insurers who are members of AIA strongly prefer to compete in the private market and the substantial majority will elect not to participate in the CPP.

The Property Casualty Insurers Association of America (PCI) press release of October 29, 2008, concurs with the AIA. The PCI Board of Governors believes property casualty

** Laura Kotelman is a Practice Specialist with Sidley Austin LLP in Chicago; limited to practice development and marketing, primarily for the Glogal Insurance and Financial Services Practice Group at Sidley.*

insurer participation in the CPP "is neither necessary nor in the best interest of property casualty consumers. The board arrived at this position because the industry is generally well-capitalized and managed and is continuing to provide sound and secure products to consumers." PCI urged Congress and Treasury to avoid imposing a recoupment tax on segments of the financial services industry that are not central to the rescue plan. "Insurers, and consumers who sponsor insurers, should not be unfairly penalized by being forced to subsidize other industries in the financial marketplace." PCI maintains that any future assessments should be imposed only on those industries involved and has been working with the Treasury to avoid federal regulation of the property casualty insurance industry and to distinguish it from other less capitalized and solvent industry sectors.

The National Association of Mutual Insurance Companies (NAMIC) press release of October 29, 2008 stated that "NAMIC's policy… is to oppose the expansion of the Treasury's Capital Purchase Program to include the property/casualty insurance industry…. Our members are not interested in participating in any type of program involving direct capital infusion from the U.S. Treasury Department…" Specifically, NAMIC's letter to the Secretary of the Treasury on October 30, 2008 stated, "A survey of NAMIC members conducted Oct. 26-28 shows that an overwhelming majority of member companies have no interest in and no need for a direct capital infusion from the U.S. government. In addition, more than half of the top executives responding to the survey believe their companies could be at a competitive disadvantage if some insurers are successful in obtaining government assistance…" NAMIC urged Treasury to exclude property/casualty insurance companies from any program that would provide direct capital assistance to insurers, and to "leave our solvent and effectively regulated segment of the financial services industry out of any new federal regulatory requirements."

Evan Greenberg, writing to the Secretary of the Treasury on October 27, 2008 in his capacity as Chairman of ACE, stated,

> The infusion of taxpayer capital into insurers (especially at far-below-market rates) will clearly disrupt the normal market forces that sort strong insurers from weak ones…. In the absence of a broken market and a public crisis, we should reward those companies who make prudent decisions and not subsidize those who do not.

Chubb's letter to Secretary of the Treasury on October 28, 2008, stated

> We do not believe that allowing property and casualty insurance companies to participate in the CPP is consistent with the stated purposes of the Act…. In addition, we urge you to consider the anti-competitive impact of bail-outs in our industry…. Participating insurers could try to use the competitive advantage afforded to them by the low-cost CPP capital to build their market share, thereby hurting other industry participants who did not need, or choose not to avail themselves of, the government bail-out under the CPP.

Chubb used the opportunity to bend Treasury's ear on regulatory modernization stating

> A more urgent need for the property and casualty industry is regulatory modernization. Our industry would operate much more efficiently without the constant changes to products, prices and practices foisted upon us by 50 separate state legislatures and 50 regulators. As Secretary of the Treasury, you have championed this type of positive change and we urge you to continue to focus on this effort as the primary source of Treasury assistance to our industry.

State vs. Federal Regulation

Treasury Secretary Henry Paulson is not ruling out the possibility of making insurance companies eligible for TARP assistance. In a press conference on November 25, he said that several insurance companies already qualified for the aid as bank holding companies, but the Treasury has not made a decision to include all insurance companies at this stage. It is not clear whether Secretary Paulson is considering requiring insurance companies to become bank holding companies or to purchase an existing bank to qualify as such, before receiving aid.

The reason that Paulson might not take action is the issue of federal oversight. Paulson is engaged in a battle of sorts with the National Association of Insurance Commissioners (NAIC), the states' insurance regulators, for control of insurance companies. He wants to bring insurance companies under federal control, and this regulatory scheme is vigorously opposed by the states.

Allowing TARP funding for the insurance industry will undoubtedly complicate the issue of regulatory control over insurers, as the state regulators and Treasury will both want oversight of the industry. State insurance commissioners currently regulate all insurance companies, but Secretary Paulson has stated his belief that insurance companies should be under some form of federal supervision. The NAIC believes that there is effective regulation at the state level and that by tapping into that strength maybe they can assist the financial regulators.

One thing is certain. Insurers that decide to purchase an existing bank would come under some measure of federal regulatory control. If an insurer brings itself under partial federal control through its own actions, will Paulson choose to support a request for TARP funding because insurers will inadvertently be subject to the federal oversight he prefers? Federal regulation would be easier to achieve with more companies already partially there.