

Third Treasury Report on Regulatory Relief: Asset Management and Insurance

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On October 26, 2017, the Department of the Treasury issued a report, “A Financial System That Creates Economic Opportunities: Asset [Management and Insurance](#),” which examines the regulation of those industries. It is the third in a series of reports written in accordance with Executive Order 13772 issued by President Donald Trump on February 3, 2017, which directs the Secretary of the Treasury to report on how the financial system is regulated and how regulation could be improved.

The report examines asset management and insurance and makes recommendations for changes to how they are regulated. The recommendations are generally aimed at providing regulatory relief and achieving certain stated goals: appropriately addressing systemic risk and firm solvency, increasing the efficiency of regulation, appropriately engaging in international regulatory forums and bodies, and promoting economic growth and informed choices. This Insight briefly examines the report and selected recommendations made in it.

Asset Management

Industry Overview

The asset management industry is comprised of a diverse range of companies and professionals—including investment companies, mutual funds, and investment advisers—that facilitate the flow of individuals’ and companies’ savings into investments, such as stocks and bonds. Before presenting recommendations, the Treasury provides an overview of the industry, including recent trends (e.g., the amount of assets under management has grown rapidly in recent decades, and in certain cases fees charged to customers have declined) and the regulatory structure for the industry. As part of this overview, the report makes several assertions that provide the rationale for most of its recommendations.

First, the report asserts that the industry is not exposed to bank-like “runs” wherein investors, fearing losses, withdraw their money *en masse*. Next, it notes that funds are regularly terminated and these liquidations generally do not cause market disruptions. Also, it argues that when market events do cause large outflows, the funds typically continue to perform well and again do not result in market disruptions. Finally, the report cites a survey of industry participants that indicates that compliance costs will likely rise significantly in coming years due to increased regulation and regulatory burden. Arguably, these characteristics support the view that certain regulations are overly burdensome.

Opponents of deregulation may dispute some of these assertions. For example, some observers argue there is run risk in asset management. When the Reserve Primary Fund—a prominent money market fund (MMF)—fell below its target value of \$1 per share in 2008, outflows from certain MMFs surged. While the Securities and Exchange Commission (SEC) has since implemented reforms to MMF regulation, risks may remain. Furthermore, the near failure of Long-Term Capital Management (LTCM)—a \$126 billion hedge fund—in 1998 arguably demonstrates that distress at an individual fund can cause market disruptions. Fourteen banks and brokerages saved LTCM from apparent imminent collapse in a deal arranged by the Federal Reserve, because certain participants believed its failure could cause chaos in financial markets.

Selected Recommendations

The report makes 30 recommendations related to the asset management industry, all of which are listed and summarized in Appendix B of the report. Treasury concludes that risks emanating from the asset management industry should be mitigated through activities- and products-based—not entity-based—regulation and recommends changes to certain rules related to liquidity risk, derivatives, exchange-traded funds, and disclosure requirements. In addition, it recommends that dual agency requirements (wherein an asset manager must meet the requirements of both the SEC and the Commodity Futures Trading Commission) and the Volcker Rule should also be amended to reduce regulatory burden. Treasury also calls for increased transparency and accountability related to international engagement and for the Department of Labor to reexamine the implications of its fiduciary rule.

Insurance

Industry Overview

Insurance is typically divided into property and casualty insurance, life insurance, and health insurance, with a wide spectrum of company sizes and types. The 2016 statistics cited in the Treasury report include a total of 780 insurers offering life and health insurance, 2,655 offering property and casualty insurance, and 1,095 offering health insurance with direct written premiums totaling \$1.5 trillion. Regulation of most of the industry, particularly the non-health lines, is primarily at the state level. There is no federal entity chartering insurers akin to the Office of the Comptroller of the Currency for banks. The Dodd-Frank Act, however, increased federal involvement in insurance, particularly by creating the Federal Insurance Office within Treasury and providing for Federal Reserve oversight over some insurers.

Selected Recommendations

In general, the report is supportive of the primary role the states play in insurance regulation and includes a legislative recommendation to ensure state regulatory primacy by clarifying the insurance exception to Consumer Financial Protection Bureau (CFPB) oversight authority. Furthermore, the report recommends that federal entities improve coordination and harmonization with state regulators on certain issues, including the creation of domestic and international group capital standards and the implementation of

financial reporting requirements of the Federal Reserve. The report is also supportive of a new approach regarding systemic risk that focuses on activities rather than the specific entity designations that have been rejected by certain state insurance regulators and insurance industry participants. Several of the issues addressed by the recommendations have drawn recent congressional attention and legislation.

Legislative Considerations

Regulators could make many of the changes recommended by the Treasury under existing authorities. However, these changes would be made only to the extent that the agencies choose to implement them. Alternatively, Congress could mandate many of the changes through legislative action if it believes the agencies will not implement the appropriate changes or will do so too slowly. In addition, the report identifies four recommendations as requiring congressional action: (1) exempting investment companies and advisers from stress-testing, (2) revising certain definitions in the Volcker Rule so that the rule is not applied to asset management companies, (3) clarifying the “business of insurance” exception to CFPB oversight authority, and (4) passing a law (provided states do not adopt uniform regulations themselves) related to insurance data security.

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