

## Market Watchers: Feds Will Soon Remove SIFI Designation From Prudential, End 'Hotel California' Regs

WASHINGTON - Prudential Financial Inc., the lone remaining insurer designated as a systemically important financial institution, will soon shed that designation as federal regulators turn away from a set of "Hotel California," regulations that previously provided no exit ramp, market watchers said.

"I expect that Prudential will be de-designated and I don't anticipate any more nonbank SIFI designations," Grace Vandecruze, managing director of Grace Global Capital, a boutique investment banking firm, told Best's News Service.

Prudential is the last SIFI standing after the Financial Stability Oversight Council on Sept. 29 voted 6-3 to remove the designation from American International Group Inc. The council declared AIG was no longer a threat to the U.S. economy ([Best's News Service, Oct. 1, 2017](#)).

"I think the industry has found the exit ramp for this Hotel California that the FSOC has set up through the Dodd-Frank Act," Vandecruze said. "It is not surprising. The Trump administration has promised to deregulate the industry, and the SIFI designation was a target of that deregulation."



Removing the SIFI designation should provide an economic boost to AIG and eventually Prudential.

"This was an overhang on the stock prices of the SIFI-designated companies and you are going to see a lift in stock prices," Vandecruze said. "Investors hate uncertainty."

In the wake of the financial crisis, the council declared three insurers — AIG, Prudential and MetLife Inc. — as potential sources of theoretical financial calamity. MetLife, which shed its designation through litigation, argued the SIFI designation was tilting the playing field in favor of undesignated competitors.

"There were added costs in compliance and it added to uncertainty and confusion," Vandecruze said. "It will be seen as a textbook case of regulation gone wrong."

In a statement released after the AIG vote, Prudential made the same point.

"Prudential has long maintained that we do not meet the standard for designation," the company said. "Now only one company is subjected to duplicative oversight — creating an unbalanced playing field and illustrating the arbitrary nature of individual designations. This underscores the need for FSOC to re-examine its process and rescind our designation."

Prudential probably won't have to wait long, said Ian Katz, director of Capital Alpha Partners.

"We can't put exact timing on it, and the FSOC process is nothing if not opaque, but we would be surprised if Prudential is still a SIFI four or five months from now," Katz said in a research note after the vote. "Having only one SIFI probably isn't something FSOC wants."

Janet Yellen, chairwoman of the board of governors of the Federal Reserve and an appointee of the previous administration, joined regulators appointed by President Donald Trump in stripping

AIG of the SIFI designation. The insurance company no longer resembles the \$1 trillion behemoth that dominated the markets before the financial meltdown, Yellen said in a statement.

“Since the financial crisis, AIG has largely sold off or wound down its capital markets businesses and has become a smaller firm that poses less of a threat to financial stability,” Yellen said. “It has reduced its assets by more than \$500 billion, wound down its Financial Products division, and sold off its mortgage insurance company.”

“Although AIG’s distress could lead to a run by policyholders on a portion of its annuities and other insurance products, the financial system should be able to handle the potential fire sales,” Yellen said.

Since it was designated on July 8, 2013, AIG’s total assets have decreased 9%, from \$549 billion at year-end 2012 to \$498 billion at year-end 2016, according to a council report on the AIG de-designation. Part of this decrease can be attributed to the divestiture of approximately \$30 billion of International Lease Finance Corp. assets that were held for sale in 2013 and 2012, the report said.

Prudential ranked ahead of AIG on a list of comparative insurers and bank holding companies, ranked by total assets, compiled by the council. MetLife Inc. tops the insurers on the list with \$898.8 billion in total assets and \$831.3 billion in liabilities; followed by Prudential, \$784 billion assets/\$737.9 billion liabilities; Berkshire Hathaway, \$620.9 billion/\$334.5 billion; AIG, \$498.3 billion/\$421.4 billion; New York Life, \$317.9 billion/\$282.4 billion; TIAA, \$302 billion/\$258.3 billion; and Lincoln, \$261.6 billion/\$247.1 billion.

Roy Woodall, FSOC independent member with insurance expertise, voted in favor of de-designation, but voiced some continuing concerns. The FSOC released written statements from some of the voting members in which they explained the reasoning behind their vote.

“I continue to be concerned regarding some of AIG’s activities, especially those relating to annuities with guaranteed features,” Woodall said. “Although I do not personally believe these activities would justify continuing to regulate AIG as a SIFI at this time, I do believe they should continue to be monitored from a macro-prudential perspective.”

Although smaller, AIG still remains a threat to the economy, said Martin J. Gruenberg, chairman of the Federal Deposit Insurance Corporation, who opposed de-designation.

“Neither AIG’s overall reduction in size since 2013, nor its divestiture of non-material operations, including those in foreign jurisdictions, have affected in any substantial manner the resolution obstacles previously identified by the FSOC,” Gruenberg said. “The asset size of the firm has only declined marginally since 2013, and the percentage of its foreign revenue and foreign assets to that of the entire firm is roughly the same.”

AIG will receive prudential supervision from the New York Department of Financial Services, rather than the Federal Reserve.

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