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The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., N.W.
Washington, D.C. 20551

Re: Federal Reserve Board Docket No. OP-1416; Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies

Dear Chairman Bernanke:

These comments are submitted on behalf of the American Council of Life Insurers (the "ACLI"). The ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. On behalf of all our members, we appreciate the opportunity to submit comments on the Notice of Intent (the "NOI") referenced above as published at 76 Federal Register 22662 (April 22, 2011).

The NOI provides notice of the intention of the Board of Governors of the Federal Reserve System (the "Board") to apply certain elements of its current consolidated supervisory program for bank holding companies ("BHCs") to savings and loan holding companies ("SLHCs") after assuming supervisory responsibility for SLHCs. As the NOI notes, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") transfers the current supervisory function of the Office of Thrift Supervision (the "OTS") related to SLHCs and their non-depository subsidiaries to the Board on July 21, 2011.

The NOI identifies three elements of the Board's current supervisory program that the Board believes are particularly critical to the effective evaluation of the consolidated condition of holding companies:

- the consolidated supervisory program for large and regional holding companies;
- the supervisory program for small, noncomplex holding companies; and
- the holding company rating system.

The NOI also discusses the Board's expectation that the application of consolidated capital requirements to SLHCs will be addressed in a forthcoming Basel III rulemaking process. The NOI states that the Board anticipates that it will assess SLHC capital using supervisory methods similar to those currently employed by the OTS until consolidated capital standards are finalized.

The ACLI recognizes that the transition of supervisory responsibility for SLHCs from the OTS to the Board is an important part of the Dodd-Frank Act regulatory initiative. At the same time the ACLI believes that a transition of this scope will present special challenges both for the Board and for the SLHC community. The challenges would be significant even in an ordinary environment. But in the current environment the challenges will be made even greater because of the numerous other regulatory changes and initiatives taking effect at the same time under the Dodd-Frank Act. The challenges for the Board will involve a substantial extension of its current supervisory function to cover a wide range of SLHCs whose business models will in many cases differ significantly from the bank-centric business models of most BHCs. For some SLHCs the business models will be heavily weighted toward non-financial business activities. Even for those SLHCs whose business models are heavily weighted to activities that are financial in nature, such as SLHCs that are insurance companies or insurance holding companies, the models will nonetheless be heavily weighted toward non-depository financial activities where the Board will historically have had little direct supervisory experience.

Moreover, for many insurance companies or insurance holding companies that own savings associations the depository institution activities will represent a very small percentage of the overall corporate entity. In some cases the depository institution itself engages in no depository activities, acting solely as a provider of trust and fiduciary services. The insurance functions of these corporate entities are also subject to a longstanding and comprehensive regulatory and supervisory system established under state insurance law and implemented by state insurance authorities. The role of the state regulatory system in the insurance business must be fully recognized in any supervisory approach that the Board develops for SLHCs with significant or predominant insurance operations. Indeed, each of these differentiating factors noted above must be carefully considered by the Board in developing an appropriate supervisory approach for SLHCs.

In the NOI the Board has noted its intention "to the greatest extent possible taking into account any unique characteristics of SLHCs" to apply its established supervisory program for BHCs to SLHCs.[1] The ACLI respectfully submits that rather than beginning in effect with the presumption that the established supervisory approach for BHCs should be applied to SLHCs, which as noted above present a significantly different and more varied profile than BHCs, the Board should develop its approach to SLHCs based on the actual business profiles and risk characteristics of the SLHC entities that the Board will be supervising. This approach has the clear advantage of structuring a supervisory program to the actual risk characteristics of the entities to be supervised rather than to a model that no matter how well designed and accepted does not reflect the characteristics (either in diversity or relative depository weight) of the SLHC entities. Rather than defaulting to the historic BHC supervisory approach, the Board should take the opportunity presented by the transfer of supervisory responsibility for SLHCs to develop a supervisory program tailored to the specific activities of the range of SLHCs that are to be supervised. This tailored approach would permit recognition of both the diversity of activities of SLHCs and the relatively smaller weight of depository institution activities in many SLHCs, which historically have been the principal driver of the BHC supervisory program. This approach also has the advantage of tailoring the supervisory approach to the actual risks presented by the individual SLHC. This tailored, risk-based approach would allow for differentiated supervision for organizations considered low-risk or noncomplex, irrespective of size. This tailored approach has the additional advantage of allowing the necessary and appropriate weight to be applied to the existing regulatory regimes for particular financial activities, such as insurance.

The ACLI respectfully submits that it would not be sound public policy to impose a model designed for a traditional BHC on an SLHC that is predominantly engaged in insurance activities or has significant insurance operations. Insurance activities are fundamentally different from traditional banking activities and BHC activities. Any risk-based approach to supervision must take recognition of this basic fact. Failure to recognize this fact would run the risk not only of overlapping or duplicative supervision, but also of conflicting or ineffective supervision.

In addition to the general observations noted above, the ACLI has the following specific observations on points in the NOI.

1. Capital Adequacy

[1] 76 Fed. Reg. at 22663

As the NOI notes, one of the important differences between the existing OTS' approach and the Board's approach to supervision relates to assessment of holding company capital. As the NOI also notes, section 171 of the Dodd-Frank Act requires that BHCs and SLHCs maintain minimum leverage and risk-based capital that is not less than the generally applicable leverage and risk-based capital requirements applied to depository institutions on July 21, 2010, which now serve in effect as a floor for any future capital requirements. These floor requirements of section 171 generally become applicable to SLHCs on July 21, 2015.[2]

The Board has indicated in the NOI that pursuant to the Dodd-Frank Act and the Basel III initiative, it is reviewing consolidated capital requirement for all depository institutions and their holding companies. The Board specifically indicated that it was considering applying to SLHCs the same consolidated risk-based and leverage capital requirements as BHCs "to the extent reasonable and feasible taking into consideration the unique characteristics of SLHCs and the requirements of HOLA."[3] The Board also indicates that it recognizes that "SLHCs have traditionally been permitted to engage in a broad range of nonbanking activities that were not contemplated when the general leverage and risk-based capital requirements for BHCs were developed."[4] We wholeheartedly agree with the latter observation and believe that it reflects a fundamentally important consideration in the development of any regulatory capital regime for SLHCs. The Basel capital program is a capital program designed specifically for <u>banks</u> by <u>bank</u> regulators. While its transposition to BHCs may be appropriate because the assets of BHCs on a consolidated basis are overwhelmingly comprised of bank assets, a reflexive transposition of Basel capital requirements to SLHCs is not appropriate because of their significantly different business profile and operations.

It would be particularly inappropriate to impose the Basel III capital requirements on SLHCs that have significant insurance operations. Such an imposition would fail to take account of the fundamental differences between insurance operations and banking operations and their capital requirements. As was noted in a 2002 joint report of the staff of the Board and the National Association of Insurance Commissioners (the "NAIC"), the different capital approaches for insurance companies and banks reflect the "inherent differences between the insurance and banking industries".[5] As was further noted in that report, the "two frameworks differ fundamentally in the risks they are designed to assess, as well as in their treatments of certain risks that might appear to be common to both sectors."[6] These differences have resulted in risk-based capital methodology in the insurance industry that is fundamentally different from the capital methodology in the banking industry.

We strongly believe that, in addition to being highly inappropriate, it makes no regulatory sense to apply bank capital rules to insurers or insurance holding companies. Forcing an insurance entity to unnaturally contort itself in order to make these bank standards 'fit' will do nothing more than provide a completely inaccurate and misleading picture of the company to regulators. Insurance companies are not banks. The liabilities and obligations of the two types of entities are very different, and so their capitalization and reserving requirements must be very different as well. We submit that it is essential that the Board recognize these fundamental differences when implementing capital requirements for SLHCs that are predominantly engaged in insurance activities or have significant insurance operations. We believe that any capital rules applied to SLHCs that have significant insurance operations and subsidiaries must take account of the different asset and liability categories in an insurance operation. We believe the best and most fundamental way to accomplish this is to recognize and accept to the greatest extent possible insurer risk-based capital standards as equivalent for this purpose. As noted

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[2] Dodd-Frank Act § 171(b)(4)(D).
[3] 76 Fed. Reg. at 22665
[4] Id.
[5] Report of the National Association of Insurance Commissioners (NAIC) and the Federal Reserve System Joint Subgroup on Risk-Based Capital and Regulatory Arbitrage (May 24, 2002) at 1.
[6] Id.

above, doing so would be in keeping with the past observations of the staff of the Federal Reserve Board on this very issue.

It may be helpful to provide a few examples of the unnatural fit of bank capital rules to insurance entities. There are various asset classes that are held by insurers that have no banking-industry equivalent and therefore do not fit within the terms of the existing bank capital risk-weightings. Separate account assets are one example of an insurer asset class with no comparable match in the banking world. Separate accounts support variable insurance products, which are designed to allow policyholders to benefit from and bear the risk of financial market investments. Although separate accounts are recorded on the balance sheet of an insurer, separate accounts pose no investment risk to the insurer because the policyholder has agreed to bear the investment risk under the contract. Requiring separate accounts to be included in a Tier 1 leverage ratio calculation would significantly inflate the total asset balance and would apply undue downward pressure to this ratio. This would place insurers at a considerable disadvantage when comparing their leverage ratios to those of banking entities where such asset types do not exist. Similarly, the unique nature of separate accounts means they would have to be risk weighted at 0% for purposes of computing the Tier 1 and Total Risk Based Capital Ratios. For guaranteed separate account assets, a "look-through" approach would be applied under which the underlying assets of such accounts would be risk weighted accordingly based on the types of assets.

Another example of fundamental difference in the Board's approach to the supervision of BHCs relates to its requirements for financial reporting in accordance with generally accepted accounting principles ("GAAP"). The Board's capital approach is generally based on GAAP calculations with specific adjustments made where the capital approach is intended to deviate from GAAP treatment. The insurance risk-based capital requirements are instead based on statutory accounting principles ("SAP") as required by state insurance law and regulation. SAP is a fundamental element of the state insurance regulatory system. State insurance laws and regulations typically require that the quarterly and annual unaudited financial statements and the annual audited financial statements filed by insurers be prepared using forms and applying accounting principles adopted from time to time by the NAIC. The NAIC has adopted comprehensive statutory accounting rules set forth in its Accounting Practices and Procedures Manual ("Manual"). These accounting rules are subject to change from time to time by the NAIC. The Manual is reprinted each year in March and marked to show changes from the prior year's Manual. In addition, the Manual is subject to formal interpretations as adopted from time to time by the NAIC's Emerging Accounting Issues Working Group. These interpretations are also published in the Manual. SAP should be recognized by the Board both for purposes of reporting requirements and for purposes of capital calculations for insurers that are SLHCs or subsidiaries of SLHC.

Moreover, as we have previously noted in our comment letter on the Board's Notice of Intent to Require Reporting Forms for Savings and Loan Holding Companies,[7] certain SLHCs including mutual insurance companies and fraternal benefit societies do not prepare GAAP financial statements. Instead these entities prepare their financial statements in accordance with SAP as required by state insurance law and regulations. As has been noted by the Board's own staff, "[s]tate insurance supervisors require insurance companies to use statutory accounting principles, which are based on a liquidation, rather than a going concern, perspective and are generally more conservative than GAAP."[8] These principles are specifically designed by the NAIC to reflect and implement regulatory and supervisory requirements of the state insurance system. The Board should permit these companies to continue to prepare their financial statements in accordance with SAP for both reporting and supervisory purposes. Requiring these companies to convert all their accounting systems to a GAAP reporting system would impose a large and unwarranted burden on these companies. Such an approach would also be inconsistent with the approach that the Board has taken with respect to the filing requirements for foreign banking

[7] ACLI Letter to Honorable Ben S. Bernanke (April 6, 2011).

[8] Subgroup Report at 7. See also OTS Holding Companies Handbook at 930B.4 ("SAP is intentionally more conservative than GAAP".).

organizations under Form FR Y-7, which permits financial statements to be prepared in accordance with local accounting practices.[9] Because SAP is statutorily mandated standard in the United States, it should *a fortiori* be accepted by the Board for purposes of reporting by those SLHCs that prepare their financial statements only in accordance with SAP.

2. Consolidated Supervision

The NOI indicates that the Board intends to apply the BHC consolidated supervision program, which has been developed essentially around a bank-centric model, to SLHCs. The NOI further indicates that such an approach would be "consistent with the authorities provide by HOLA".[10] While such an approach may be consistent with the "authorities" provided by HOLA, it nonetheless represents a significant change from the approach historically taken by the OTS. The OTS approach has been based among other considerations on the diverse range of enterprises in the SLHC community and on the need to frame the supervisory approach based both on the complexity and risk presented by the individual enterprise.[11]

The Board also indicates that it does not believe that the application of the BHC consolidated supervisory program to SLHCs would require "any specific action on the part of SLHCs prior to the transfer date or cause burden in an ongoing basis."[12] The ACLI respectfully submits that a comparison of the guidance contained in the Board's Supervisory Letter 08-9/CA 08-12(Oct. 16, 2008) and its attachments with the guidance contained in the OTS Holding Companies Handbook suggests that the Board has significantly underestimated the actions that many SLHCs would have to take and the time needed to effect those actions in order for these SLHCs to meet expectations reflected in the Board's guidance. For example, the approach taken to enterprise-wide risk management is likely to vary substantially across the range of entities that qualify as SLHCs. In many SLHCs the risk functions may be more closely aligned with individual operating entities than might be envisioned in an enterprise-wide risk management function. Management information systems may also not be as fully integrated as would be envisioned in an enterprise-wide risk management model.

Depending upon their existing business and regulatory model, various SLHCs may have to undertake significant changes to the configuration of their risk and control functions or provide for significant enhancements to these functions and to their management information systems to meet the expectations reflected in the Board's guidance. These changes should be preceded by a collaborative dialogue between the individual SLHC and the staff of the Board once the staff has become familiar with the SLHC and its range of operations because a single template will not fit all the entities that will become subject to Board supervision. The need for this collaborative dialogue should be noted by the Board as it considers the timeline for issuing formal guidance or notices of proposed rulemaking following the transfer date. Appropriate lead time will also have to be provided to SLHCs to implement any changes or enhancements to their existing policies, procedures, infrastructure and systems to reflect the guidance in the Board's documents. This need for lead time should be expressly recognized in any formal guidance that the Board ultimately adopts with respect to its supervisory program for SLHCs.

3. Holding Company Rating System

The Board has indicated in the NOI that it is considering transitioning SLHCs from the current OTS rating system to the Board's rating system for BHCs as the Board conducts its own independent supervisory assessment of the condition of an individual SLHC after the transfer date. Based on its analysis of the OTS rating system for SLHCs and the BHC rating system, the Board believes that there is a substantial overlap between the two rating systems. As the Board notes, however, one area of difference between

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[9] *See* General Instructions for Preparation of the Annual Report of Foreign Banking Organizations FR Y-7, Report Item 1: Financial Information Regarding the Foreign Banking Organization (FBO).
[10] 76 Fed. Reg. at 22663.
[11] *See* OTS Holding Companies Handbook §§ 100, 930B, & 940.
[12] 76 Fed. Reg. at 22663.

the two rating systems arises from the fact that SLHCs are not currently subject to regulatory capital requirements (although the current OTS rating system does involve a case-by-case assessment of capital). The Board has indicated that it intends to propose consolidated capital standards for SLHCs. We have provided our thoughts on the appropriate considerations for the Board in developing capital standards for SLHC that have significant insurance operations in the preceding sections of this letter.

In the NOI the Board indicates that until consolidated capital standards for SLHCs are finalized as part of a future rulemaking, the Board anticipates that it will assess SLHC capital using supervisory quantitative and qualitative methods similar to those currently employed by the OTS. We support the need for such a transitional approach to the assessment of capital. We support the need for an appropriate transition for any new capital standards that would be imposed on SLHCs as either a supervisory or regulatory matter. An appropriate transitional approach must also be used in connection with the other components of the BHC rating system, particularly those that are dependent upon assessments made under the guidance provided in the Board's Supervisory Letter SR 08-9/CA 08-12 discussed above. As we noted above, individual SLHCs may require significant time to implement changes or enhancements to their risk and control functions and management information systems to meet the expectations reflected in the Board's guidance documents. Prospective supervisory assessments of SLHCs by the Board should expressly take recognition of the fact that there must be a transition period to allow SLHCs to implement the changes and enhancements to meet the expectations reflected in the Board's guidance documents.

We appreciate your thoughtful consideration of our views on this matter. As has been noted, the issues involved here are of significant importance to our member companies, and we would welcome the opportunity to discuss them further with you and your staff at your convenience.

Respectfully submitted,

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