From: American Council of Life Insurers, David M. Leifer

Proposal: 1536 (7100-AE50) - Incentive-Based Compensation Arrangements

Subject: Incentive-Based Compensation Arrangements

Comments:

Date:Jul 22, 2016

Proposal:Incentive-based Compensation Arrangements [R-1536]
Document ID:R-1536
Revision:1
First name:David
Middle initial:M
Last name:Leifer
Affiliation (if any):American Council of Life Insurers
Affiliation Type:Commercial (Com)
Address line 1:101 Constitution Ave, Ste 700
Address line 2:
City:Washington
State:District of Columbia
Zip:20001
Country:UNITED STATES
Postal (if outside the U.S.):

Your comment:July 22, 2016

Robert deV. Frierson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551
Re: Notice of Proposed Rulemaking Concerning Incentive-based Compensation Arrangements
Docket No. 1536
RIN No. 7100 AE-50

Dear Mr. Frierson:

On behalf of the American Council of Life Insurers ("ACLI") and its 280 member life insurance companies, we are writing in response to the request of the Board of Governors of the Federal Reserve System (the "Board") for public comment on the proposed Joint Rules implementing the incentive-based compensation requirements of the Dodd-Frank Act (Joint Rules). As always, we welcome the opportunity to provide our views on a regulatory proposal of significance to the life insurance industry. ACLI has twelve member companies that own depository institutions within their holding company structures, and therefore qualify as Saving & Loan Holding Companies (SLHCs). These entities are directly impacted by the Joint Rules.

Our fundamental concern with the Joint Rules is that they can and will indirectly apply to insurance companies that own such entities otherwise subject to the Joint Rules, despite the fact that there is no indication that any consideration was given to the operations of insurance companies and the unique nature of the risks assumed by insurance companies in such operations. The Joint Rules are based exclusively on an analysis of large banks and the assets and risk profiles of those entities.

This omission is particularly troublesome in light of the regulatory regime applicable to insurance companies. Oversight of the safety and soundness of these companies is under the jurisdiction of state insurance regulators. Congress enacted the McCarran-Ferguson Act to allow states to regulate the business of insurance. Nothing in the Dodd-Frank Act was intended to preempt or impair the intent that the regulation of insurance operations is under the jurisdiction of the states. Application of the Joint Rules to insurance companies, especially without thoughtful and careful consideration of the differences in the business models and associated risks of such entities compared with the operations of large banks that were studied in developing the Joint Rules, is certain to create extensive conflicts with the duties, responsibilities and pronouncements of state insurance regulators. At a minimum, thoughtful consideration of these existing regimes should have been undertaken to determine whether an exemption from the Joint Rules was warranted, or whether the Joint Rules may violate the directive of McCarran-Ferguson.

As opposed to the large banks that were reviewed and extensively studied with respect to the development of the Joint Rules, life insurers offer long-term products and services such as life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, providing financial and retirement security to 75 million American families. The industry pays out $1.5 billion every day to families and businesses, and is a cornerstone of the U.S. economy, generating 2.5 million jobs and investing $5.2 trillion to support economic expansion. Life insurers invest in America for the long-term. Life insurers are a major source of bond financing, holding 20% of all corporate bonds and significant government bonds, most in long-term obligations. This difference in the nature of the products and services provided to consumers necessarily dictates a materially different risk profile with respect to how insurers conduct their investments as compared to commercial banks that focus much more heavily on shorter-term investments and returns.

The prescriptive limitations and constraints applicable to compensation design promulgated by the Joint Rules were developed solely with a view to businesses with radically different investment and risk profiles from insurers. Without proper consideration of these differences, the pronouncements in the Joint Rules cannot operate efficiently and effectively to protect or promote the interests of the clients relying on insurance companies for their long-term security. Without proper tailoring by the Board, prescriptive incentive compensation requirements will unnecessarily burden insurance companies with no discernable benefit to their policyholders. The insurance markets and, more appropriately, our customers are best served by regulations that have been carefully and specifically designed for the insurance business model. Therefore, to best achieve that outcome, we request that the Board exempt insurance SLHCs from the proposal and consider a tailored principles-based approach. This approach will preserve the Board's ability, under its safety and soundness authority in the Home Owners' Loan Act of 1933, to examine an insurance SLHC's incentive compensations practices utilizing principles-based supervisory guidance in order to ensure that such practices are designed and are operating in a safe and sound manner based on the unique characteristics of the organization.

ACLI Urges an Exemption for Insurance Companies from the Proposal and Further the Adoption of a Tailored Principles-based Approach

ACLI supports appropriate rules intended to ensure the proper oversight of insurance companies. As the Board has developed rules implementing the various other aspects of Dodd-Frank applicable to SLHCs, it has worked diligently to produce appropriate standards for these entities. For example, such a tailored and thoughtful approach is demonstrated by the current evaluation of consolidated capital standards for SLHCs. In that circumstance, the Board is striving to ensure the capital adequacy of SLHCs, but is modeling its work by reference to the existing insurer risk-based capital system specifically designed by insurance regulators as a holistic, comprehensive and accurate measure of insurance entity risks. This implicit recognition of the unique characteristics of insurance companies' business models and balance sheets is critical to avoiding a bank-centric outcome that could impede and might potentially undermine the long-term viability and financial strength of insurance companies.

We believe it is inappropriate to apply prescriptive incentive-based compensations rules to insurance SLHCs. These entities are less complex and not systemically connected to the broader financial system in the same manner as banking institutions. It is apparent that the Board's prescriptive proposed standards are based almost exclusively on its experience supervising large banking institutions. Application of overly prescriptive incentive-based compensation rules designed for banking institutions to insurance companies would be wholly inappropriate. In addition, it would place insurance

SLHCs at a significant competitive disadvantage in their ability to attract and retain high performing executives and key employees' vis-à-vis insurers that are not Board-supervised. Moreover, these rules would impose significant regulatory compliance burdens on insurance SLHCs that would clearly outweigh any safety and soundness benefit. In fact, the competitive disadvantage in attracting and retaining top-flight talent and the significant compliance costs and risks could arguably make these insurance SLHCs less safe and sound. In likely recognition of the foregoing facts and circumstances, Congress directed the Board and other banking regulators to apply and enforce Section 956 pursuant to Section 505 of the Gramm-Leach-Bliley Act of 1999 (GLBA). As explained in further detail below, GLBA does not provide the Board and other banking regulators with enforcement authority over SLHCs and persons providing insurance.

In our view, the Board needs to evaluate any proposed incentive compensation requirements with a view towards ensuring an outcome that is compatible with insurance risks and compensation practices. This needed analysis was not undertaken in promulgating the proposed Joint Rules. ACLI believes that a proper evaluation of the differing considerations would lead to a tailored principles-based approach that enables SLHCs (and insurers with other covered entities) with substantial insurance operations to design appropriate incentive& based compensation programs in consideration of their size, complexity, and risk profiles. Therefore, ACLI requests that the Board exempt insurance SLHCs from its current proposal.

Additional Concerns with the Joint Rules Incentive-based Compensation Definitions and Application

The proposed definition of incentive-based compensation is overly broad, vague and will be difficult to apply within an insurance company. Incentive compensation is so vaguely defined under the proposal as to be meaningless, capturing virtually any variable compensation. The definition fails to distinguish between variable compensation systems that reward specific individuals, therefore arguably rewarding specific risk taking, versus variable compensation systems that reward a broad class of employees based on enterprise or company-wide performance metrics that a single individual within the organization would have no meaningful way to impact. The factors and timeframes of the proposal are prescriptive without any evident nexus to actual risk management. Far preferable would be an exemption from the current proposal while putting forward a principles-based approach that accurately identifies truly risky behaviors and subjects these, and only these, to the deferrals, claw backs and other requirements of the Joint Rules.

Further, the prescriptive approach the Board has taken will lead to competitive disadvantages and impose considerable compliance costs for insurance companies that will be subject to the Joint Rules. This approach will harm such insurance companies by limiting their ability to attract and retain talented employees. The inability to retain critical personnel will impair the security provided to their customers, without providing them any corresponding benefit because the prescriptions are designed to address concerns unrelated to the investments made by such companies.

The Joint Rules Improperly Included General Account Assets as Subject to Material Loss
General Account assets of insurance companies should not be included within the definition of total consolidated assets subject to material loss. These assets are subject to robust regulation (e.g. significant trading restrictions). Including general account assets in the consolidated asset definition will distort the Joint Rules' impact on insurance companies by, among other things, improperly sweeping in individuals who are non-risk takers within the company as being subject to the compensation requirements. Insurance company general accounts are already subject to robust regulation and therefore should not be included in the Board's proposal.

ACLI Believes there are Significant Gramm-Leach-Bliley Concerns

An additional reason to treat insurance companies separately stems from the proposed enforcement provision of the Joint Rules, which relies on Section 505 of the GLBA. This provision explicitly vests enforcement.