Prudential

Robert M. Falzon, CFA
Executive Vice President and CFO

Prudential Financial, Inc.
751 Broad Street
Newark. NJ 07102
Tel 973-802-9257 Fax 973-802-9280
robert.falzon@prudential.com

Via E-Mail

August 17, 2016

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Re: Enhanced Prudential Standards for Systemically Important Insurance Companies - Docket No. R-1540, RIN 7100 AE 54

Dear Mr. Frierson,

Prudential Financial, Inc. ("Prudential") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Board") on its proposed rule ("Proposed Rule" or "Proposal") to apply enhanced prudential standards to systemically important insurance companies ("Insurance SIFIs").[1]

Prudential shares with the Board the goal of establishing a supervisory framework that is appropriately tailored to account for the differences in the business models, capital structures and risk profiles of insurance groups, and recognizes that the Board has adapted certain aspects of the Proposal to achieve this objective. However, the Proposed Rule in most respects is identical to the provisions of the Board's Regulation YY that currently apply to the largest banking organizations.[2] In our view, enhanced prudential standards for Insurance SIFIs must be more thoroughly informed by the particular characteristics of the insurance business, taking due account of the substantial differences between large banking organizations and large insurance groups[3]

Enhanced Prudential Standards for Systemically Important Insurance Companies, 81 Fed. Reg. 38610 (June 14, 2016).

[2] *See* 12 C.F.R. pt. 252.

As the Board is aware, various provisions of Section 165 of the Dodd-Frank Act (e.g., Section 165(a)(2)(A)) require the Board to tailor application of prudential standards to Insurance SIFIs, a mandate that is also reflected in the Insurance Capital Standards Clarification Act of 2014. Prudential believes that the additional tailoring requested in this letter, particularly requests to maintain existing

Section I of this comment letter focuses on the need to further tailor the Proposed Rule with respect to liquidity risk management standards. We believe that the stability of insurers' balance sheets over time and the relative absence of run risk in insurance activities support a different approach to liquidity risk management than that reflected in the Proposal, Our comments explain the modifications we propose with respect to cash flow projections, liquidity stress-testing, and the type of assets that may be included in the liquidity buffer.

Section II of this comment letter addresses the Proposed Rule's requirements for corporate governance and the management of risks other than liquidity, suggesting that they should be modified. We propose that the final rule reflect a less prescriptive approach to these matters, allowing the Insurance SIFIs to maintain governance and reporting arrangements that have proven to be effective. Finally, in Section III, we explain the need for changes to the implementation schedule reflected in the Proposal.

I. Liquidity Risk Management

As noted by Governor Tarullo in his May 20, 2016 remarks to the National Association of Insurance Commissioners, the funding structures of insurance groups are much more stable and less exposed to runs than those of banking organizations, supporting a different calibration of the liquidity requirements for insurers.[4] However, we recognize, like Governor Tarullo, that certain activities conducted by insurance groups, such as securities lending, commercial paper borrowings and derivatives used for hedging purposes, may create additional liquidity risks in times of market stress. Our comments below suggest that the Board adopt a more focused approach to the liquidity risk management standards, whereby only such activities would be subject to requirements similar to those currently applicable to large banking organizations under Regulation YY.

Before offering specific comments on the Proposal, we wish to highlight several points we believe support Governor Tarullo's observations about insurers' funding structures, and that should guide the Board's approach to developing liquidity risk management standards for Insurance SIFIs that reflect their important differences from banking organizations:

arrangements that facilitate effective risk management and arc consistent with existing stale insurance law, regulations and best practices, would be consistent with this mandate.

Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Insurance Companies and the Role of the Federal Reserve 5 (May 20, 2016) ("Here, though, the major relevant difference is that the funding structures of traditional insurers are generally much more *stable* than the funding structure of commercial banks, much less broker-dealers.") (Emphasis supplied.)

- The balance sheets of banking organizations and insurance groups are significantly different. Banking organizations generally combine complex and opaque assets with significant deposit, wholesale funding and other short-term or contingent liabilities that are acquired by their holders for the express purpose of maintaining liquidity, and which therefore pose liquidity risk in times of stress. Many large banking organizations, unlike Prudential and other insurance groups, also engage in payment, clearing and settlement activities, or serve as dealers or market-makers in financial instruments, creating significant intraday liquidity exposure.

- In contrast to banking organizations, the risk profiles of insurance groups are not subject to significant change over the short run *(i.e.,* monthly, quarterly and annually), Liabilities accumulate over years (and in many cases decades) of product sales, and are matched with transparent assets reflecting the conservative "buy and hold" strategy that is central to the insurance business. For example, over the past decade, Prudential's U.S. life insurance in-force differed on average by 2-3% from quarter to quarter and by 1% from month to month, including during 2008 and 2009. Unlike banking organizations, insurance groups can rely on a stable source of funding through the premium payments they receive, And, under State insurance laws and regulation, insurance companies must generally maintain significant amounts of available assets on a stand-alone legal entity basis, resulting in lower structural liquidity risk than banking organizations.

- Policyholders do not "run" from an insurer as depositors do from a bank because insurance is purchased to obtain the <u>protection</u> insurance provides, not as a source of liquidity or discretionary funds. Life insurance and annuities are purchased primarily for long-term financial protection upon death or retirement. In the event of policy surrender, policyholders would be subject to a loss of insurance coverage for which they had already made a significant investment in the form of prior premium payments, and which they might not be able to replace at comparable prices due to declining health, industry-wide changes in product offerings, changes in interest rates or equity markets, or other reasons. Many policyholders may become uninsurable; policies may be significantly more expensive; and coverage may be more limited. Policyholders may find it difficult, if not impossible, to replace an insurance policy on similar terms due to changes in policyholder age or health conditions. Surrender may also result in the loss of guarantees or other unique product features that are no longer available in the marketplace and for which the policyholder has bargained and paid. Simply put, policyholders are highly disincented to give up the likely irreplaceable protection for which they have already paid.

- Indeed, there are also a number of economic, legal and contractual disincentives to surrendering policies. For life insurance, the cash surrender value is typically much less than the amount that would be payable upon maturation of the policy, and a surrender charge is assessed. Surrenders by annuity contract holders are similarly subject to charges. Surrender of some policies may result in loss of minimum crediting rate or other guarantees. Policyholders may also have to pay significant switching costs. There are also typically tax penalties for withdrawing funds from life insurance policies and annuities. In sum, the run-like mass surrender of insurance policies would require large numbers of policyholders to act against their self-interest.

- Prudential's experience during the recent financial crisis illustrates the preceding points. Throughout that period, the cash value of individual life insurance surrenders as a percentage of mean future policy benefits, policyholder account balances and separate account balances never exceeded 4.2%, a percentage in line with prior years (from 2001 to 2007) and within 1 % of the lowest such percentage during that period. Likewise, annual surrenders and withdrawals by individual annuity contract holders actually *declined* during the financial crisis, as holders valued the protection provided by these products in a time of market-wide stress. Also, during this period. Prudential continued to be a net investor in the financial markets.

- These factors, along with other characteristics of the insurance business, have led the regulatory community to recognize, as the Board has, that core insurance activities generally do not present systemic risks.[5] We believe they have specific implications for the liquidity and other risk management standards that should apply to Insurance SIFIs.

A. Cash-Flow Projections

Because insurance group risk profiles are relatively stable period-to-period, a requirement to produce and update comprehensive enterprise-wide short-term cash-flow projections on a daily basis and long-term cash-flow projections on a monthly basis would create significant and undue burden and expense without corresponding supervisory benefits. Significant portions of Prudential's cash flow profile are highly unlikely to undergo significant changes during a daily or monthly period and, as a result, generating such comprehensive projections with respect to these timeframes would not provide useful information for the Board or Prudential itself. For this reason, the Board should not establish a blanket requirement for Insurance SIFIs to perform or update comprehensive enterprise-wide short-term cash-flow projections on a daily basis or longer-term cash-flow projections on a monthly basis.

As indicated above, Prudential acknowledges that Insurance SIFIs may engage in certain activities *(e.g.,* securities lending, commercial paper borrowings, and derivatives used for hedging purposes) that potentially present shorter-term liability risks. In recognition of these activity-specific risks, Prudential respectfully requests that the Board consider an alternative, risk-based approach whereby we would perform comprehensive

See, e.g., International Association of Insurance Supervisors, *Insurance and Financial Stability* (Nov. 2011), *available at* http://www.iaisweb.org/page/supervisory-material/other-supervisory-papers-and-reports/file/34379/insurance-and-financial-stability-november-2011.

enterprise-wide short- and longer-term cash flow projections on a quarterly basis, and undertake a comprehensive evaluation of the liabilities underlying our activities at least annually (as well as when new or material changes in existing activities require) and, based on that evaluation, determine whether projections should be performed more frequently than quarterly with respect to specific liabilities. This evaluation would be subject to review by Board examiners as part of the supervisory process to determine whether more frequent projections are warranted for certain activities.

Quarterly cash flow projections, coupled with robust quarterly stress testing, would provide ample information for the Board and insurance groups to understand and assess liquidity risk, in light of their risk profiles, which do not change rapidly. As noted previously, given the stability of Prudential's liability- and asset-side risk profile, more frequent projections would create a significant and undue burden and expense without corresponding supervisory benefits. In addition, requiring short and longer-term cash flow projections on a more frequent basis may actually divert both company and supervisory resources from other liquidity risk management activities, such as robust stress testing, that provide far greater benefits. Finally, Prudential develops actual financial results only on a quarterly basis. Requiring comprehensive projections of future financial results on a more frequent basis than actual financial results would necessitate significant and costly modifications to the company's systems and organizational infrastructure without corresponding benefit.

B. <u>Stress Testing Frequency and Planning Horizon</u>

As in the case of the proposed cash-flow projections, we do not believe that a requirement to conduct comprehensive, enterprise-wide liquidity stress tests on a monthly basis is warranted, given the generally stable risk profile of insurance groups. Accordingly, and consistent with the activities-based approach described above, we propose that liquidity stress tests be performed on a quarterly basis and that an evaluation be conducted to determine whether certain activities should be subject to more frequent stress testing.

The requirement to conduct liquidity stress tests over a 7-day planning horizon should be similarly focused on only those activities that could generate material short-term liquidity risks. We believe that the 30-day time horizon is more than sufficient to review the emergence of any liquidity risks that may arise for the vast majority of an Insurance SIFI's liabilities. Accordingly, Prudential suggests that the 7-day time horizon be applied to specifically identified activities, and that an Insurance SIFI otherwise be required to conduct comprehensive liquidity stress tests using the 30-day, 90-day and 1-year time horizons.

C. Contractual Stays

The Proposed Rule would not permit Insurance SIFIs to take into consideration contractual rights to defer payments as a source of liquidity in stress testing. The Board states in the preamble to the Proposed Rule that, although insurance contracts in some instances may allow insurance companies to defer payments by up to six months at the election of either the company or their insurance regulator, "[crediting stays would be inconsistent with preventing the failure or material financial distress of a systemically important insurance company," asserting that "[s]tays are measures of last resort that systemically important insurance companies would be very hesitant to invoke for reputational reasons."[6] The Proposed Rule also asserts that a stay by a systemically important insurance company could have substantial adverse systemic implications.

We note that contractual stays are valid and useful mechanisms that serve an important risk-mitigating function, and in appropriate circumstances, may simultaneously enhance the safety and soundness of insurance groups, protect policyholders and mitigate potential macroprudential risks. The preamble to the Proposed Rule does not cite any empirical data supporting the assertion that invoking contractual rights inevitably would result in reputational harm or that companies in distress have foregone exercising these contractual rights. By contrast, we understand the exclusion of payment stays when imposed by a regulator or where an Insurance SIFI must obtain regulatory approval before exercising any such contractual rights to delay payments, since, in each case, the use of the payment stay is outside the control of the Insurance SIFI.

However, because contractual stays can serve as an important risk mitigant in certain stress events, and because an insurer may in fact use these contractual rights in the case of a stress event if it determines that the benefit of doing so outweighs any potential reputational harms, we do not support the Board's broad exclusion of all contractual stays from all liquidity stress testing results. We are concerned that ignoring such a potentially important tool may actually distort liquidity stress testing results and, in turn, adversely affect any management decision-making that is based on those results. It may also create a disincentive for insurers to include these risk mitigating features in their contracts. Thus, we believe the Board should permit Insurance SIFIs to include in stress testing the use of contractual stays that the company can invoke without regulatory approval, so long as the company's assumptions regarding their use in a particular stress scenario are documented, reasonable, and tailored to the particular stress scenario in which they are used.

Based on the stress scenarios currently contemplated by Prudential, contractual stays (including traditional six-month contractual delays incorporated into many retail insurance products, which we believe to be the focus of the Board's concern) are not

81 Fed. Reg. 38619.

utilized; however, there may be certain extreme stress scenarios where their use may be appropriate. Hence, the Board should not require a broad exclusion under any and all stress scenarios. Product design is a well-recognized first line liquidity risk mitigant, supported by insurance regulators, and should be recognized by the Board.

More importantly, we believe that any liquidity stress testing requirements should not be interpreted to require Insurance SIFIs to entirely exclude from their liquidity stress testing and contingency planning the use of risk mitigating policy or contract features that reduce credit or market risk by providing an insurance company with the option to choose among alternative policy payment arrangements. For example, certain stable value products sold through Prudential's Retirement business permit the company to pay contract balances to institutional customers in installments if certain withdrawal thresholds are reached. Other contracts allow the company to pay only the market value of account balances upon withdrawal and provide for a waiting period, which can be up to several years, before the entire book value of account balances must be disbursed.

These features serve an important risk mitigating function for the company, They are disclosed to potentially affected customers and effectively bargained for as part of product pricing and sale. Institutional customers understand the payment terms of these products, and we believe they understand and anticipate that the company may exercise these contractual rights. We note that these provisions also protect general account policyholders by reducing the likelihood that they will receive reduced crediting rates or contractual payouts in a stress scenario. We do not believe it is self-evident that serious reputational harm would result from invoking these contractual features in appropriate circumstances and the Board provides no evidence in support of its supposition.

In light of these considerations, we request that the Board explicitly distinguish among (i) payment stays that are imposed by a regulator or that require prior regulatory approval, which we agree should be excluded from stress testing, (ii) contractual stays that may be included in liquidity stress testing, if based on appropriate assumptions, and (iii) credit- and market risk-mitigating product features that are an integral part of the products themselves, particularly with respect to institutional products (such as those, referred to above, permitting the company to pay contract balances to customers in installments in some circumstances), and should be permitted to be used in stress testing in all cases.

D. <u>Inclusion of Borrowings in Liquidity Stress Testing</u>

Prudential concurs with the Board's decision to tailor the proposed liquidity stress testing requirements by providing that an Insurance SIFI's liquidity buffer be measured against a 90-day time horizon. However, the Proposed Rule would prevent an Insurance SIFI from including in its liquidity stress tests, for the 7-day, 30-day and 90-day planning horizons, proceeds received from committed future borrowings. This approach stands in contrast to Board Regulation YY, which permits covered banking organizations to treat lines of credit as an available funding source for liquidity stress tests with a time horizon of greater than 30 days.[7]

We believe that the Proposed Rule should be revised to permit Insurance SIFIs to include proceeds from committed future borrowing sources (such as lines of credit) in both the liquidity buffer and stress tests for the 90-day time horizon, as it would be inappropriate for the Board to treat Insurance SIFIs differently from banking organizations when applying the same liquidity stress test time horizons to both classes of firms.

Moreover, including such sources of committed future borrowings is warranted in light of the FRB's conclusion that a 90-day stress event is likely to be long enough for lending markets to function during at least some of that time period. In other words, it is reasonable to assume that an Insurance SIFI would be able to access available funding at some point during a 90-day time horizon, aligning with the treatment afforded to banking organizations under Regulation YY. This conclusion is supported by the fact that Prudential maintains highly diversified sources of committed credit across multiple lenders and geographies, making it even more likely that the firm could access funding during the 90-day period. In sum, any determination about a company's ability to use committed funding sources should be part of the assessment of each individual stress scenario, as there may be stress scenarios during which the overall markets remain strong and functioning and where committed funding sources can be tapped.

In addition, Insurance SIFIs should be permitted to treat pre-funded liquidity sources *(i.e.,* where liquid assets are contractually committed or otherwise belong to the Insurance SIFI) that present no meaningful counterparty credit risks and do not transmit systemic risk as available sources of funding and liquid assets for purposes of liquidity stress testing and the liquidity buffer. For example. Prudential currently maintains a put-option with a Delaware trust that permits Prudential to sell to the trust, at any time at Prudential's option, up to $ 1.5 billion of Prudential senior debt securities and receive in return U.S. Treasury securities already held by the trust. These types of arrangements present no meaningful counterparty risk (including to any financial sector entity) and were established for the very purpose of securing such a reliable, alternative source of funding. Accordingly, these types of pre-funded liquidity arrangements should be treated as available funding or assets for liquidity stress testing and buffer purposes. We believe this approach would also help incentivize insurers to obtain reliable and diverse sources of liquidity.

E. <u>Intraday Liquidity Risk Monitoring</u>

Prudential supports the Board's determination to require an Insurance SIFI to establish intraday liquidity monitoring procedures only "if necessary for its business."[8]

See 12 C.F.R. 252.35(a)(5)(iii).

This standard appears to reflect recognition that intraday liquidity monitoring may not be useful or relevant to an Insurance SIFI's risk management framework. For example, Insurance SIFIs generally do not engage in the types of payment, clearing and settlement activities that give rise to intraday liquidity risks. Similarly, although an Insurance SIFI may engage in derivatives activity related to hedging, this should not be viewed as necessarily creating intraday exposure that affects the company's liquidity position in a material and adverse way. In Prudential's case, these contracts hedge risks relating to long-dated insurance contracts, meaning that overall credit and counterparty risks remain relatively constant over time.

We recognize that for certain types of cleared derivatives, futures commission merchants ("FCMs") may require customers to post variation margin on an intraday basis, but FCMs typically do not exercise this right. They make margin calls on an overnight basis and either charge customers a fee for providing the funding overnight or pay the customer an investment rate on positive intraday positions. Moreover, cleared derivatives make up less than 20 percent of the notional value of Prudential's derivatives book. Accordingly, Prudential should not be required to engage in intraday monitoring of even this activity, as these intraday exposures would not affect its overall liquidity position in a material way.

F. Liquidity Buffer

We acknowledge the Board has proposed a 90-day period for the liquidity buffer in recognition of distinctions between insurance groups and banking organizations. Prudential urges the Board to recognize further these important distinctions in developing the additional liquidity buffer requirements that would apply to Insurance SIFIs. For example, insurance groups hold significant amounts of high quality assets in the general accounts of their insurance company subsidiaries and have the ability to pledge these assets (including corporate fixed income securities) if needed to obtain liquidity. In contrast, banking organizations generally hold far smaller amounts of pledgeable assets, and would be required to immediately monetize assets during a liquidity event, such as being required to immediately provide cash to satisfy demand deposit liabilities.

1. "Liquid and Readily-Marketable " Standard - Treatment of Corporate Fixed Income and Other Securities

In determining whether instruments held by Insurance SIFIs are eligible for inclusion in the liquidity buffer, the Board should revise the "liquid and readily-marketable" definition, particularly the requirement that a security have a high trading volume, which places undue emphasis on trading volumes as a measure of liquidity. Past trading volumes alone are not a reliable indicator of liquidity in a stress event, particularly for those securities that are purchased under a "buy and hold" strategy. In

81 Fed. Reg. 38628.

fact, securities sometimes experience higher trading volumes because of market concerns or uncertainty regarding the issuer, meaning that trading volume does not always correspond with the stability of a particular security or its function as a safe asset during a stress event.

The disconnect between asset quality and trading volume is particularly apparent in the case of high quality fixed income securities, which are often purchased immediately at issuance and held for significant periods (in many cases, to maturity) by a single buyer. For this reason, the Board's statement that investment-grade corporate bonds should only be includable in the buffer if they have a "proven record as reliable sources of liquidity during stressed market conditions," as evidenced by trading volume, is unwarranted, as it assumes, incorrectly in our view, that a lack of significant trading activity with respect to an asset necessarily means that the asset will not maintain value or demand during a stress event.

As a result, the "liquid and readily marketable" definition could inappropriately be interpreted to exclude from the liquidity buffer certain high quality corporate bonds held by insurance groups as part of their core "buy and hold" investment activities. Prudential believes that such a wholesale exclusion would be unjustified and would unfairly penalize insurance company investment activities, which involve buying and holding longer-duration fixed income securities. Although by their nature these securities tend to be scarcer in markets, this does not necessarily suggest an absence of liquidity. In addition, such a requirement could have the inadvertent consequence of reducing the incentive for Insurance SIFIs to engage in the fixed income investing that provides meaningful benefits to the real economy. Accordingly, the Board should at the very least eliminate the "high trading volume" requirement and permit Insurance SIFIs to recognize as eligible for inclusion in their liquidity buffers all investment grade corporate bonds and similar long-duration securities.

Prudential believes that high quality asset-backed securities ("ABS"), commercial mortgage-backed securities ("CMBS"), and municipal revenue bonds should also be includable in the liquidity buffer so long as their liquidity characteristics mirror those of includable corporate debt securities. As in the case of investment grade corporate bonds, certain high-quality ABS, CMBS and municipal revenue bonds will likely retain value and demand as safer assets in a stress event. The Board should permit them to be treated as eligible liquid assets if they have the same characteristics as corporate bonds that would otherwise be included in the buffer.

The Board can, if needed, establish an alternative additional standard with respect to these instruments, and in this regard, Prudential supports the potential inclusion of alternatives such as the price stability test suggested in Question 22 of the preamble to the Proposed Rule, *i.e.,* a requirement that an investment grade corporate bond or similar long-duration instrument can be includable in the buffer if it has not experienced a decline in price of 20% or more over the past 30 days. However, we believe that changes in an issuer's credit spread can provide a better measure of a bond's liquidity and should be the primary factor on which to base such a test. Prudential believes that such alternatives would appropriately allow an Insurance SIFI to include high-quality fixed income securities that are fundamental to the business of insurance within its liquidity buffer, while preventing the inclusion of particular bonds or assets that would not maintain substantial value during a stress event. We encourage the Board to consult further with industry in developing an appropriate alternative approach.

2. *Inclusion of Bank Deposits in Liquidity Buffer*

Prudential believes that cash deposits held at banks (including demand and time deposits) should be eligible for inclusion in the liquidity buffer. Insurance SIFIs hold deposits for the very purpose of having reliable sources of immediate liquidity, and their exclusion would lead to the absurd result of excluding from the buffer one of the most liquid forms of financial instalment, while at the same time negatively impacting liquidity risk management practices at Insurance SIFIs by incentivizing the replacement of cash with less liquid instruments. This would ultimately have a detrimental effect on Insurance SIFIs' liquidity positions and could also increase exposure to interest rate and credit risks.

It would be inappropriate to prohibit Insurance SIFIs from including bank deposits in its liquidity buffer, while at the same time permitting banking organizations to recognize cash and Federal Reserve Bank (or other central bank) balances as available liquidity.[9] Unlike banks, insurance groups without depository institution affiliates, such as the Insurance SIFIs, are not members of the Fedwire system and are not permitted to have accounts with the Federal Reserve, and, as a result, cannot hold cash on deposit with central banks. To account for this distinction, the Board should permit Insurance SIFIs to recognize alternative categories of liquid assets, such as bank deposits, that can be utilized in a fashion similar to central bank deposits.

Similarly, certificates of deposit ("CDs") should be treated as eligible liquidity buffer assets, as they are a proven source of liquidity for market participants and meet the "liquid and readily-marketable" standard set out in Regulation YY and the Proposed Rule, due to the fact that an active short-term trading market for CDs exists among institutional investors. Separately, CDs with residual maturity of 90 days or less should also be includable in the liquidity buffer as they would turn to cash within the 90 day time horizon. Importantly, institutional CDs present little or no macroprudential risks, as holders are generally prohibited from redeeming them prior to maturity. We do not believe, in any event, that Prudential's bank deposits constitute material exposures for our banking organization counterparties.

See 12 C.F.R. 252.35(b)(3)(i)(A). ***See also*** 12C.F.R. 249.20(a)(1), (2).

Further, the Board's LCR standard explicitly requires banking organizations to assign outflow rates to wholesale and other deposit liabilities, in effect recognizing that corporate depositors would be able to access bank liquidity during a stress event. [10] Permitting an Insurance SIFI to include bank deposits as eligible buffer assets would align with this approach, which is appropriately based on the correct understanding that deposit funds would be available in a stress event.

The evident liquidity of cash should provide a sufficient basis for the Board to include bank deposits in the liquidity buffer. In addition, as part of its risk management practices, Prudential monitors its bank balances, and as of June 30, 2016 none of its individual relationships represented more than 0.25% of a bank's overall deposits. Prudential believes that this diversification effect is meaningful and greatly reduces the risk that any of its deposit relationships could in any way contribute to or amplify systemic stresses or shocks, Prudential urges the Board to recognize the fundamentally low-risk characteristics of these deposit banking arrangements, and permit an Insurance SIFI to include bank deposits in the liquidity buffer when held in accordance with appropriate risk management standards.

3. *Financial Sector Entity Issuers*

The Proposed Rule would permit Insurance SIFIs to include certain publicly traded common equity securities or investment-grade corporate debt securities in their liquidity buffer, but specifically excludes securities issued by a financial sector entity ("FSE") or a consolidated subsidiary of an FSE. The proposed exclusion tracks a similar exclusion in the Board's LCR standard for banking organizations, and as such, appears to be motivated by concerns regarding "wrong-way" risk, *i.e.,* the risk that counterparty exposures may be adversely correlated with the credit quality of other financial intermediary counterparties.[11]

Insurance SIFIs should be permitted to treat instruments issued by FSEs as eligible liquidity buffer assets, as wrong-way risk concerns appear greatly reduced in the case of an insurance group's counterparty relationships. Unlike banks and other financial intermediaries, the vast majority of an Insurance SIFI's stressed cash-flow needs are not directly correlated with the credit quality of FSEs, *i.e.,* changes in cash-flow needs will be based on events unrelated to changes in counterparty credit risk. Accordingly, permitting an Insurance SIFI to include in its liquidity buffer instruments issued by FSEs would not generate significant amounts of wrong-way risk, and therefore should be permissible.

See 12 C.F.R. 249.32(h).

Liquidity Coverage Ratio: Liquidity Risk Measurement Standards, 79 Fed. Reg. 61440,61452 (Oct. 10, 2014).

The Board should also include money market mutual fund ("MMF") shares as eligible liquidity buffer assets. MMF shares continue to serve as cash-like assets in the financial markets, and as such should be accorded permissive treatment under any liquidity buffer standard. Post-crisis reforms in MMF regulation have strengthened the ability of MMF shares to serve as safe assets in a stress event, particularly over a 90-day time horizon, further supporting the view that they should be treated favorably for purposes of the liquidity buffer.

II. Corporate Governance and Risk Management

Prudential believes that the proposed corporate governance and risk management requirements, which largely mirror the governance and risk management requirements for banking organizations under Regulation YY, are unnecessarily prescriptive. Instead of importing almost wholesale the Regulation YY regime, the Board should opt for a principles-based approach that permits Insurance SIFIs to establish and maintain governance and risk-management arrangements that align with established organizational structures and practices that have proven effective, yet still achieve the underlying policy objectives of the Proposed Rule, by ensuring the (i) stature and importance of the risk management function and (ii) provision of timely and complete information about the firm's enterprise-wide risk profile that facilitates board oversight of Prudential's material entities and core business lines. In this regard, we note that Board examiners will always have discretion to address insufficiencies should they develop.

A. Board of Directors

Prudential has established risk management practices with respect to its board of directors and board committees that ensure the board and senior management obtain timely and comprehensive information about the company's risk profile. Prudential should not be required to alter these effective practices in order to conform to the prescriptive requirements of the Proposed Rule, which are apparently designed to mirror the structures of bank holding company SIFIs. There is no evidence that Prudential's approach is any less effective. For example, the Proposed Rule would require the Risk Committee of the board to approve all enterprise-wide risk-management policies. Given Prudential's board committee structure, this is not the most effective and appropriate division of labor. For example, the Investment Committee of Prudential's board of directors reviews and approves the company's Investment Risk and Market Risk Policy, and the Audit Committee of the board reviews and approves the company's Model Risk Management Policy because they are most directly involved in assessing and overseeing these risks. The policies are also provided to, and reviewed with. Prudential's Risk Committee.

These arrangements allow the relevant committees to bring to bear their specialized knowledge and focus, without sacrificing the enterprise-wide perspective on risk provided by the Risk Committee. Prudential believes that this current structure demonstrably preserves the independence of its risk function, is appropriately tailored to the composition of its board committees and the expertise of its directors, and that a change in this structure would not enhance the effectiveness of its risk management and corporate governance frameworks and would needlessly disrupt the smooth functioning of the board of directors.

B. Management Reporting

The Board likewise should not dictate specific management reporting lines or practices for the Insurance SIFI's CRO or CA absent concrete evidence - and there is none - that existing structures are inadequate, Currently, Prudential's CRO reports to the Vice Chairman who, in turn, reports to the Chief Executive Officer ("CEO"). We believe that this reporting arrangement is appropriate in light of the Vice Chairman's risk management experience and Prudential's overall organizational structure, which allows for close coordination among senior management, the board of directors (of which the Vice Chairman is a member) and the risk management function, while still preserving the independence of risk management vis-a-vis the CEO and other senior management. The Proposed Rule takes no account of this arrangement or of the unnecessary imposition of additional reporting responsibilities on the CEO. We suggest that the Board avoid disrupting effective existing arrangements like Prudential's so long as the supervisory aims of the Proposed Rule are achieved.

Prudential has a similarly effective existing structure for actuarial reporting. Prudential's CA reports on the adequacy of the company's insurance reserves to the Finance Committee of the board of directors. This reporting structure fits well with other oversight responsibilities of the Finance Committee due to the interrelationship between reserves and capital in determining an insurance group's total loss absorption capacity. There is no reason for shifting this to the Audit Committee, which already has substantial other responsibilities, and in fact would disrupt the coordinated oversight of company issues by the various committees. As with the CRO's reporting line to the Vice Chairman, governance standards for Insurance SIFIs should not over-prescribe the manner in which the CA's board reporting obligations are fulfilled. The standards should require only that the CA report to the board or an appropriate board committee on actuarial matters, including on the adequacy of insurance reserves, recognizing that more than one approach can be effective in ensuring appropriate attention by the board of directors to actuarial issues.

In both cases, Insurance SIFIs should be permitted to preserve the CRO's and CA's existing information and reporting practices with respect to the board of directors and board committees, absent clear evidence of ineffectiveness. For example, Prudential should be permitted to preserve existing practices with respect to the frequency, scope and nature of reporting from the CRO to the Risk Committee and from the CA to the Finance Committee. Prudential strongly believes that these existing arrangements achieve the underlying policy objectives of the Proposed Rule: the CRO's current reporting arrangements provide the Risk Committee with the information necessary to "fully understand the institution's corporate governance and risk-management framework and have a general understanding of its risk management practices," and the CA's reporting to the Finance Committee ensures an "enterprise-wide view of reserve adequacy across legal entities, lines of business, and geographic boundaries."[12] Prudential suggests that the final rule allow these arrangements. The imposition of additional or different administrative reporting arrangements to the board or its committees would not enhance the stature or independence of the CRO or CA functions at Prudential.

III. Phase-In and Transition Arrangements

Under the Proposed Rule, an Insurance SIFI would become subject to the Proposed Rule beginning on the first day of the fifth quarter following the effective date of any final rule.

Prudential believes it currently maintains a robust risk management infrastructure and management information systems that are appropriately designed for and tailored to Prudential's business, and that provide its board of directors and senior management with sufficient information to effectively oversee the enterprise, particularly with respect to liquidity risk. That said, if implemented as proposed, the Proposed Rule would undoubtedly require Prudential to undertake significant enhancements to systems and organizational infrastructure to bring itself into compliance with the Proposed Rule, certain elements of which, as discussed in this letter, may not yield meaningful risk management or supervisory benefits and may serve to divert company and supervisory resources from more valuable liquidity risk management activities.

Prudential believes that the costs associated with this build-out would be substantial, and that the Board underestimates these costs in its Impact Assessment. For example, the Insurance SIFIs would likely be forced to significantly enhance existing systems to meet the proposed cash flow projections requirements, leading to far more additional costs than the "relatively modest" amounts predicted by the Board.[13]

In recognition of these significant changes, the Board should extend the generally applicable phase-in period to the first day of the thirteenth quarter following the effective date of the final rule. As noted previously, Prudential believes that its existing risk management framework already provides its board and senior management with the information necessary to effectively understand and manage liquidity risk throughout the enterprise, and thus an extended transition period should not present concerns from a supervisory or overall safety and soundness perspective.

[12] 81 Fed. Reg. 38612, 38613.

[13] 81 Fed. Reg. 38622.

We believe that a shorter phase-in would be feasible if the Board accepts the tailoring to the Proposed Rule suggested in this letter, particularly with respect to cash flow projections and liquidity stress tests, which should result in a meaningfully reduced administrative and compliance burden. If the Board does engage in the requested tailoring, Prudential believes that a nine-quarter transition period strikes the appropriate balance between the need for implementation of the standards and the required design and implementation of the numerous significant policies, procedures, processes and systems required for compliance.

If the Board is unwilling to grant a general extension with respect to the implementation of the standards contemplated by the Proposal, then the five-quarter transition period should at least be extended with respect to the proposed cash flow projection and liquidity stress testing requirements, which will require the most significant investments in systems and organizational infrastructure.

IV. Conclusion

We thank the Board for consideration of our comments. If you have any questions or need further information, please contact me (973-802-9257; robert.falzon@prudential.com) or Ken Tanji, Senior Vice President and Treasurer (973-367-2984; kenneth.tanji@prudential.com).

Respectfully Submitted,

/ I J s

Robert M. Falzon
Executive Vice President and
Chief Financial Officer