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

Re: Notice of Proposed Rulemaking (Docket No. R-1540; RIN 7100 AE 54) on Enhanced Prudential Standards for Systemically Important Insurance Companies

Dear Mr. Frierson:

American International Group, Inc. (AIG) appreciates the opportunity to offer comments on the Federal Reserve Board's ("Board") notice of proposed rulemaking ("NPR") on enhanced prudential standards for systemically important financial institutions (SIFIs) with significant insurance activities.

We support the Board's commitment to developing standards for corporate governance, risk management, and liquidity risk management that are tailored to the capital structures and risk profiles of insurance companies. We believe that the NPR, in significant measure, appropriately reflects the governance and risk management practices that are fundamental to the prudent and productive management of insurance groups. Indeed, AIG's current internal framework and approach to corporate governance, risk management, and liquidity risk management align meaningfully with the proposed standards.

At the same time, AIG has identified several aspects of the proposed standards that will require further refinement and modification in order to fully achieve the Board's commitment to a tailored framework. Implementing a standard that comprehensively reflects insurance risk profiles is essential to ensuring that supervised institutions focus their resources efficiently on the norms, practices, and operations that are most directly instrumental to prudent enterprise-wide governance, risk management, and liquidity risk management.

With respect to the governance proposals, we see three aspects which, if implemented with the unique features of the insurance business in mind, would achieve the Board's goals and support insurance group oversight and efficiency.

- **Risk Committee focus.** We believe the standard should encourage insurance groups, which constantly and in every facet of their business identify, assess, analyze and mitigate risk, to focus their risk committees broadly on all potential sources and dimensions of such risk, including, for example, issues related to capital.

- **Co-chief actuaries.** We strongly endorse providing for co-chief actuaries, a measure that appropriately reflects the inherent differences between the property and casualty and life insurance businesses.

- **Co-chief actuaries report to Audit Committee.** We believe the proposed standard is best implemented in a way that makes sure that the insurance group Audit Committee is well informed on all matters that impact the group's finances, including by means of regular actuarial reports on reserving and related matters from the co-chief actuaries and oversight of those experts, without taking the further step of creating some form of managerial-style reporting line to a board committee that would add unnecessary complexity and potential confusion.

We believe that the core first principle of the Board's liquidity risk management standards should be that insurance companies, which have inherently stable funding profiles and typically do not rely on short-term wholesale funding, are much less likely than banks to contribute to the illiquidity-driven "fire sales" at the heart of the Federal Reserve's concerns about systemic risk. Insurance company exposure to "fire sale" risk is significantly mitigated by several fundamental characteristics of its funding model and risk management, including the long-established discipline of managing asset and liability maturity profiles to reduce exposure to short-term asset market volatility (reinforced by cash flow testing requirements by various insurance subsidiary regulators); a typically inverted liquidity profile, since premium payments are received in advance of liabilities incurred over the longer-term; and the provision of liquidity transformation at the longer-end, rather than shorter-end, of the maturity curve.

Across both non-life and life insurance activities, there are numerous contractual and conventional attributes that mitigate "run risk" related to financial market stresses.

- Certain products contain contractual mitigants that deter or dis-incentivize their redemption by policyholders, such as surrender penalties; contractual limitations on put-ability; negative tax implications; and the loss of valuable economic benefits (e.g., death benefits; crediting rates above prevailing market rates).

- Diversification effects mean that insurance-related liquidity stresses, particularly for property and casualty, occur independently of financial stresses and are therefore unlikely to contribute to a forced selling episode.

- Particularly within property and casualty, there tends to be a timing lag between the occurrence of an event and the payout to claimants. For example, for major hurricanes, payouts within the first few months are typically a small fraction of ultimate losses to the insurer.

- Surrendering or canceling policies, and refunding any unearned premium, is not on demand, unlike bank deposits.

- The customization of property and casualty policies to client needs dis-incentivizes switching to other providers.

In AIG's view, there are three critical dimensions for further tailoring the Board's liquidity risk management proposal to better reflect insurance industry modalities.

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- **Recognizing liquidity provided by financial institutions.** AIG recognizes that a core objective of the Board's systemic risk policy mandate is to reduce interconnectedness within the financial system, in order to deter the potential transmission of risks across institutions and sectors. We are empathetic to the Board's concerns about potential extrinsic risks of this nature. However, the NPR takes an overly conservative and counterproductive "all-or-nothing" approach to this issue by essentially disallowing all forms of liquidity provided by other financial institutions.

  - We believe that a more effective policy approach would be to address these legitimate concerns about interconnectedness by ensuring that insurance SIFIs develop and apply counterparty exposure limits, which would prevent excessive reliance on funding concentrated in a few large institutions. A prudent internal framework for counterparty limits should enable recognition of reliable sources of bank-provided funding, such as syndicated committed facilities.

  - It is essential that insurance SIFIs be able to recognize cash as a liquidity source, particularly since banking organizations are able to recognize Federal Reserve Bank balances, an institutional benefit not available to insurers. Additionally, to be appropriately tailored for global insurance groups, the criteria for liquid assets needs to recognize the localized jurisdictional aspects of liquidity management. For activities settled in local currencies, bank deposits must be recognized as an essential, low risk, and well-established form of liquidity, particularly in the absence of investment alternatives.

  - We also believe that the optimal mechanism for mitigating the potential systemic impact of liquidity draws is already operative. Namely, the Federal Reserve's comprehensive program for banks to stress test their capital and liquidity adequacy addresses the systemic impact of a counterparty drawing on banks as providers of liquidity during periods of market disruption. The Board's extant stress testing of liquidity providers, in this regard, is a more refined and effective policy mechanism than a blanket prohibition on well-established and tested forms of liquidity for insurers.

- **Reflecting the lower volatility in available liquidity over a 90-day (versus 30-day) stress horizon.** AIG supports the Board's view that the assessment of an insurer's short-term liquidity buffer should be based on a longer horizon than the 30-day period underlying the assessment of banking organizations. The greater stability and relative illiquidity of most insurance liabilities means that the sources of available liquidity should be appropriately defined and calibrated over a relatively longer period. We believe that the Board must recognize this longer assessment horizon, and its beneficial impact on the sources of available liquidity, in the following respects.

  - The definition of "highly liquid assets" should be broadened to reflect the commensurately wider scope of liquidity sources that can be monetized over a 90-day (versus a more restrictive 30-day) period. For example, we believe that higher quality mortgage-related exposures, with appropriate haircuts, can provide a valuable source of liquidity over a 90-day horizon. Such treatment would accord with an improved ability, over a 90-day versus 30-day period, for insurers to access the Federal Home Loan Bank (FHLB) system as a provider of liquidity against high quality mortgage-backed securities and real estate loans.

- Additionally, haircuts applicable for a 90-day monetization window should be lower than haircuts for a 30-day stress period, given the potential for greater normalization in asset and funding markets over a relatively longer horizon.

▪ **Refining the scope, cadence, and horizon of certain liquidity assessment processes.** The NPR proposes several forms of liquidity adequacy testing, which, in concept and construct, appear useful to the Board's prudential objectives and consistent with what, in AIG's view, are productive and necessary disciplines for assessing and managing liquidity risk across the firm. Indeed, many of the proposed practices are ones that AIG has already embedded in our internal framework for assessing liquidity risk. At the same time, we believe that certain technical aspects of the processes proposed in the NPR would benefit from further tailoring to insurance organizational structures and risk profiles, which would in turn promote a more focused assessment of the forms and manifestations of liquidity risk that are most relevant to insurers.

  - The **scope** of liquidity assessments, in the initial implementation of these standards, should in certain cases focus primarily on major legal entities, inclusive of parent, rather than on a complete enterprise-wide view. Such prioritization would both recognize the fundamental importance of liquidity management on an entity level and also capture the prevailing risks to the enterprise as a whole, as smaller operating entities are typically a negligible contributor to a group's overall liquidity risk exposure. Over time, and as the standards are implemented, these assessments can be broadened to include additional entities where merited.

  - The prescribed **cadence** of certain projections should carefully consider whether more frequent runs would provide meaningful additional informational utility. For example, given the relative stability in insurance liabilities, which are largely driven by fundamental actuarial assessments rather than by day-to-day market dynamics, we believe it is sufficient to perform longer-term cash flow projections on a quarterly basis, rather than the monthly cadence proposed in the NPR. We suggest that the Board generally require a less frequent cadence for its "business-as-usual" processes, provided that the institution has the capability to perform more frequent assessments, as needed, if market stresses were to emerge.

  - The **horizon** of certain processes should also reflect the generally longer-term perspective inherent in the insurance business model. As one example, we believe that the assessment of intraday liquidity risk, while relevant for banks that are actively engaged in processing and trading operations, is largely not useful for insurance-related activities. We believe that, in practice, performing intraday assessments would only provide value for a limited number of non-insurance activities.

We look forward to continuing productive dialogue with the Board in the further refinement and implementation of prudential standards that will be productive for supervised institutions, the Board, and external stakeholders alike. To follow are AIG's responses to the specific questions posed in the NPR.

Respectfully Submitted,

David W. Junius
Treasurer

NPR: AIG response to questions

Question 1: The Board invites comment on all aspects of the proposed rule, including in particular the aspects noted in more detailed questions at the end of each section.

Question 2: The Board invites comment on the 40 percent threshold contained in the proposed definition of systemically important insurance company. Would an alternative measure be more appropriate? Why or why not?

In AIG's view, we agree with the Board's objective of ensuring that the capital rules tailored to insurance companies are only applied to institutions whose level of insurance activity is significant, rather than incidental, to the group's overall activities. However, we think it is useful for the Board to apply a measure of context-specific judgment, rather than relying solely on fixed thresholds.

Question 3: Are there additional qualifications and experience that the Board should require of a member or members of the risk committee of a systemically important insurance company?

We believe that the qualifications and experience described in the NPR are instrumental to effective oversight of a nonbank SIFI's enterprise risk management and are sufficient to meeting the Board's prudential objectives for sound governance.

Question 4: The Board invites comment on whether the structure of the risk committee and the duties proposed to be assigned to the risk committee are appropriate.

In general, we find the structure of the proposed risk committee to be appropriate, including membership requirements and its status as an independent committee of the parent company's Board of Directors. The duties proposed for the risk committee, including oversight of the company's global risk management framework and establishment of its risk management policies, reflect best practices and the norm at this and other large insurers. We would urge the Board, however, not to be too restrictive in its interpretation of the proper business of a risk committee whose "sole and exclusive function," as the NPR states, should be to oversee a company's global risk management framework and approve risk management policies. While we fully support the objective of effective parent board risk oversight, we believe that success is more likely if the manner of achieving that goal is not overly prescriptive. Permitting a degree of flexibility regarding agenda items of insurance group risk committees is justified for two important reasons.

The first goes to the heart of the nature of the insurance business. It is not uncommon to find in the charters of risk committees of large U.S. insurance organizations provisions that give the risk committee a role in the widest possible variety of risk-related matters including jurisdiction to approve, or recommend to the full board approval of, a number of finance-related capital actions. Unlike other types of companies, insurance groups deal with risk in every facet of their operations. Virtually every aspect of their business requires the ability to identify, analyze, measure, and mitigate risk. Capital policy and capital actions are no exception. An integrated review of such policies and actions proposed by management, including select capital actions, is best performed in an insurance group's risk committee, whether that committee ultimately approves them or recommends action by the full board.

Second, the risk committee is not only the most effective forum for addressing the capital actions of insurance groups but also it is the most efficient. To require a separate committee to address only capital actions does not seem like a productive use of Directors' time. We view the limited number of capital actions considered by our current committee as integral to the business of an insurance group's risk committee and risk management oversight. We believe the committee members are well-suited to deal with all facets of these issues to the advancement of the safety and soundness as well as the efficient operation of the organization.

Question 5: Are the responsibilities and requirements for the chief risk officer and the chief actuary of a systemically important insurance company appropriate? What additional responsibilities and requirements should the Board consider imposing?

With regard to the chief risk officer, we believe that the responsibilities and requirements proposed for that officer are appropriate.

We agree with the Board's statement in the NPR that actuaries at insurance companies serve a critical role. The National Association of Insurance Commissioners (NAIC) and state insurance laws have long recognized the importance of the actuarial function in establishing sound estimates concerning the amount and timing of insurance benefit payments. In accordance with NAIC model statutes and regulations as generally followed in the various states, an insurer appoints an actuary to oversee the performance of an asset adequacy analysis in accordance with applicable actuarial standards and to prepare and submit to the relevant State Insurance Commissioner an annual Statement of Actuarial Opinion on the adequacy of reserves. In addition, the appointed actuary prepares a year-end loss reserve report, a memorandum to the company describing the analysis done in support of the opinion regarding the reserves and other important information. Both the Statement of Actuarial Opinion and supporting documents are presented to and discussed with the insurer's Board of Directors. In addition, more frequent reports on the insurer's actuarial function are generally provided to the insurer's Audit Committee, addressing various topics, including reserve adequacy, assumptions, calculations and estimates, and other matters. For a number of insurance groups, state law also requires that the Audit Committee of the group parent participate in the oversight of subsidiary insurers, including financial and actuarial matters.

The Board's proposal would require an insurance group's co-chief actuaries to report directly to the Audit Committee of the parent company's Board of Directors and also would allow additional lines of reporting. As stated in the NPR, these steps are proposed in order to ensure that the co-chief actuaries attain a measure of stature and independence from the lines of businesses and legal entities. We believe that an effective relationship with the Audit Committee and appropriate committee oversight can be achieved by requiring the co-chief actuaries to make regular reports to the committee on the adequacy of reserves, the estimates, assumptions and calculations that stand behind actuarial opinions, and any other questions that may arise.

It is not necessary or appropriate to complicate and increase the number of reporting lines by seeking to establish the actuarial function, a management function overseen by senior finance officers, under the Audit Committee. We also believe that the relationship fostered under state insurance law, with its emphasis on regular reporting, creates the most effective model of Audit Committee oversight of actuarial work and would greatly advance the Board's goals. This is consistent with the Financial Actuarial Judgments process established at AIG, as communicated to the Fed.

Question 6: Should the Board require a single, enterprise-wide chief actuary instead of allowing the position to be split between life and property and casualty operations? Why or why not?

At AIG, we already maintain at the parent company level an enterprise-wide view of reserve adequacy across legal entities, lines of business, and geographic boundaries and we support the Board's goal of ensuring that this is done. Due to the distinct structures of the life insurance business and the property and casualty business, we favor the Board's approach of allowing insurance groups that maintain substantial business in both lines to employ co-chief actuaries under the proposed rule.

The factors noted by the Board justify this approach. The professional requirements of property and casualty and life actuaries, their separate professional organizations and the actuarial techniques they employ in each business, do indeed differ starkly. Since reserve estimates are driven by the specific insurance business pursued by the relevant licensed entities, it would not necessarily enhance the quality of such estimates or enterprise-wide results to appoint a single Chief Actuary, who would inevitably have more experience in one type of actuarial work than the other.

Question 7: The Board invites comment on whether there are additional liquidity risk management responsibilities that the rule should require of senior management.

We believe that the identified senior management responsibilities are appropriate and, when applied rigorously, would obviate certain of the more prescriptive standards outlined in other aspects of the NPR. Notably, the application of liquidity risk limits to prevent undue concentrations in funding sources is critical to addressing the Board's macro-prudential concerns about financial institution interconnectedness. To that end, we suggest a slightly modified approach. A thoughtful and consistently applied set of counterparty limits, focused on restricting reliance on specific providers of liquidity, may be a more effective policy mechanism than prohibitions on cash, letters of credit, committed syndicate facilities, and other well-established sources of liquidity in a stress event.

Question 8: The Board invites comment on whether the above requirements are appropriate for managing cash flows at systemically important insurance companies. Should any aspects of this cash-flow projection requirement be modified to better address the risk of systemically important insurance companies?

Question 9: Should the Board consider a different level of frequency for requiring systemically important insurance companies to update their cash flow projections? If so, what frequency would be appropriate and why?

We support the Board's focus on projecting cash flows on a comprehensive basis, encompassing all material liquidity exposures. We believe that the appropriate application of this requirement is to focus on projecting cash flows for the major legal entities, inclusive of the parent holding company, reflecting both the fundamental importance of liquidity management on an operating entity level and the limited informational utility of performing resource-intensive projections on smaller entities with negligible liquidity risk exposure.

We also believe that, given the relative stability in insurance liabilities, which are largely driven by fundamental actuarial assessments rather than by day-to-day market dynamics, it is sufficient to perform longer-term cash flow projections on a quarterly basis, rather than the monthly cadence proposed in the NPR. We suggest that the Board generally require a less frequent cadence for "business-as-usual" processes, provided that the institution has the capability to perform more frequent assessments, as needed, if market stresses were to emerge.

The scope, frequency, and horizon of cash flow projections should be differentiated based on the liquidity risk profile of the entity. For example, non-life insurance activities pose minimal liquidity risk and are demonstrably non-systemic, given their lack of correlation with financial market stresses, contractual and product features that mitigate put-ability, and the conventional timing lags between the occurrence of an event and the ultimate payout to the claimant. For example, for major hurricanes, payouts within the first few months are typically a small fraction of ultimate losses to the insurer. In this regard, for property and casualty activities, the assessment of liquidity risks over short-term horizons (e.g., less than 30 days) does not provide much if any informational value.

Similarly, life and retirement products often contain penalties, tax considerations, or financial incentives that make it uneconomical to surrender the contract even during stress periods, which in turn limits the informational utility of performing shorter-term liquidity risk assessments.

For capital market-related activities that are sensitive to short-term market movements (e.g., derivatives, short-term wholesale funding), we believe that more frequent cash flow projections might be warranted, which might occur more frequently in some entities than others.

Question 10: The Board invites comment on whether the above requirements for a contingency funding plan are appropriate for systemically important insurance companies. What alternative approaches to the contingency funding requirements outlined above should the Board consider?

Question 11: Should the proposed rule allow systemically important insurance companies to plan for any delay or stay of payments to *policyholders or other counterparties within their contingency funding plans? Why or why not?*

Question 12: What specific information should a systemically important insurance company be required to include in its action plan to describe the strategies that the company would use to respond to liquidity shortfalls for identified liquidity stress events?

In AIG's view, the proposed requirements for contingency funding plans are largely appropriate and consistent with our internal approach. However, for buffer testing, we believe that business-as-usual sales of highly liquid assets for short-term funding needs are sufficient to demonstrating operational readiness and control.

We also note that U.S. state insurance laws provide regulators the ability to stay certain claims, which enables ample time for the insurer to pay liabilities in an orderly fashion and, in turn, significantly obviates the potential for "fire sales" in a resolution situation. In this respect, the application of stays is an important differentiator from the banking resolution model and significantly mitigates insurers' systemic risk footprint.

Question 13: The Board invites comments on whether there are specific activities that, if carried out by a systemically important insurance company, should result in a requirement that the company engage in intraday liquidity monitoring?

We believe that intraday liquidity monitoring, while relevant for banks that are actively engaged in processing and trading operations, is largely not useful for insurance-related activities. In practice, performing intraday assessments is pertinent only to a narrow scope of capital market-related activities that are sensitive to short-term market movements, such as derivatives, exchange-traded products, and short-term wholesale funding activities, which are conventionally not significant drivers of an insurance group's overall liquidity risk profile.

Question 14: Are the proposed stress testing horizons ranging from 7 days to 1 year appropriate?

We agree that the proposed stress testing horizons are appropriate and represent a comprehensive range of periods over which the different forms of liquidity risks could materialize.

Question 15: How often should systemically important insurance companies be required to conduct stress tests? What are the costs and benefits of such a frequency?

We urge the Board to consider the interplay of capital and liquidity stress testing, and potentially aligning these processes, where feasible. For an insurance group, potential capital needs identified through a stress test may need to be met through an inter-company transfer of financial resources, which can have a concomitant impact on the liquidity profile of both the enterprise as a whole and on particular entities.

The optimal frequency of performing stress tests depends on the liquidity profile of the underlying entity, as well as the frequency of related processes such as cash flow projections and capital stress testing. More specifically, the monthly cadence that the Board proposes in the NPR would be appropriate for market-related activities that are sensitive to short-term financial movements. However, less frequent updates would be needed for assessing the impact of liquidity stresses related to core insurance products, whose liquidity profile tends to be less sensitive to fast-moving scenarios. For example, property and casualty lines conventionally experience significant lags between the occurrence of an event and the ultimate realized loss on the contract, meaning that performing more frequent liquidity re-assessments provides limited informational utility.

Question 16: What changes, if any, should be made to the definition of available cash-flow sources for the liquidity stress tests? How should the proposed standard treat separate account and closed block assets?

AIG disagrees with the NPR's assertion that FHLB funding is an unreliable source of liquidity for insurance companies during a period of stress, particularly given the potential for stabilization in financial markets over a 90-day versus 30-day stress horizon. An important aspect of tailoring the Board's enhanced prudential standards is to recognize that an insurance company's liability structure, unlike that of a large complex banking institution, is considerably less vulnerable to short-term, market-driven runs, which affords the insurer greater flexibility in accessing sources of funding that might face short-term disruptions, such as the FHLB system.

Additionally, from a macro-prudential perspective, it is generally preferable to encourage mechanisms that allow for monetization through collateralized funding via well-established institutional mechanisms, rather than through the distressed sale of securities that are of high quality but are experiencing temporary liquidity dislocations. Recognition of FHLB funding would also enable the Board to take greater comfort in the inclusion of higher quality mortgage-related securities, with appropriate haircuts, within the liquid asset buffer for a 90-day stress.

Question 17: In what scenario, if any, would delaying payments to policyholders be effective in allowing a systemically important insurance company to continue operating as a going concern without adverse impact to the company's reputation, ability to attract and retain business, and cash flows? Should systemically important insurance companies be allowed to assume that they would delay payments to policyholders in liquidity stress testing (including for purposes of calculating the liquidity buffer requirement described below)? If so, under which scenarios and planning horizons would this be appropriate and what documentation, planning, and other requirements should be placed around this? Are there historical data to support an alternative approach to the one contained in the proposal?

AIG generally believes that the focal point of assessing available liquidity on a "going concern" basis should be on forms of liquidity that can be reliably monetized, subject to reasonable price volatility as reflected through appropriate haircuts, either by a security sale, liquidity draw, or as collateral in a well-established funding channel, such as through the FHLB system.

Question 18: What other changes, if any, should be made to the proposed liquidity stress-testing requirements (including the stress scenario requirements and required assumptions) to ensure that analyses of stress testing will provide useful information for the management of a systemically important insurance company's liquidity risk? What alternatives to the proposed liquidity stress-testing requirements, including the stress scenario requirements and required assumptions, should the Board consider? What additional parameters for the liquidity stress tests should the Board consider defining?

AIG's responses to the NPR questions represent our views on the areas of the NPR's liquidity stress testing proposals that require further modification to align with insurance business models and risk profiles.

Question 19: Is 90 days the right planning horizon for calculation of the buffer? Why or why not?

We believe that, while the 90-day horizon seems compatible with the goal of assessing short-term liquidity stresses for insurance companies, the broader and more crucial issue is that the design and assumptions underlying the stress test are meaningful and appropriately tailored to the insurance business model. Critically, the highly stable liability and funding profile of insurance companies, relative to banking organizations, should translate to a commensurately broader recognition of available sources of liquidity, through both a wider scope of includible forms of liquidity and relatively lower haircut assumptions.

Additionally, it is important to recognize that, for a significant proportion of insurance liabilities, there would be negligible outflows even under conditions of stress. For example, the risk profile of property and casualty products is largely uncorrelated with the typical drivers of liquidity event risks, and the payout pattern in the event of a claim is staggered through a horizon that is in many cases well beyond 90 days.

Question 20: Do the proposed rule's stress testing and liquidity buffer requirements appropriately capture restrictions on the transferability of funds between legal entities within a consolidated organization? Why or why not?

AIG believes that the NPR's requirements appropriately reflect considerations around inter-company transferability. AIG carefully manages liquidity at an entity-level, with a heightened focus on material entities, and we agree that the parent has an important role in managing group-wide liquidity needs.

Question 21: The Board invites comment on all aspects of the proposed definition of "highly liquid assets". Does the definition appropriately reflect the range of assets that an insurer could use to meet cash outflows over the extended 90-day time horizon?

Question 22: Should the board include specific requirements that specify when an asset can be considered a source of liquidity during stress (e.g., less

than a 20 percent drop in price within 30 days)? If so, what should those requirements be?

Question 23: Should bank deposits be eligible as highly liquid assets? Why or why not?

Question 24: What changes, if any, should be made to the proposal's guidance concerning the discounting of assets relative to their fair value? How should these discounts vary based on the length of the stress test's planning horizon?

AIG strongly urges the Board to reconsider its overly restrictive definition of highly liquid assets, in particular its prohibition of cash and other forms of reliable and well-established liquidity provided by financial institutions. We recognize the Board's concerns about interconnectedness and the potential for transmission of risks across the financial system. However, the NPR's restrictions are overly narrow and counterproductive to the promotion of sound liquidity risk management in a stress scenario.

We believe that a more nuanced and effective policy approach would be to address the Board's legitimate concerns about interconnectedness by ensuring that insurance SIFIs develop and apply counterparty exposure limits, which would prevent excessive reliance on funding concentrated in a few large institutions.

It is essential that insurance SIFIs be able to recognize cash as a liquidity source, particularly since banking organizations are able to recognize Federal Reserve Bank balances, an institutional benefit not available to insurers. The exclusion of cash could create an undesirable incentive for insurers to use less liquid investments as an alternative, which increases overall liquidity risk to the firm.

We also believe that the optimal mechanism for mitigating the potential systemic impact of liquidity draws is already operative. Namely, the Federal Reserve's comprehensive program for banks to stress test their capital and liquidity adequacy addresses the systemic impact of a counterparty drawing on banks as providers of liquidity during periods of market disruption. The Board's extant stress testing of liquidity providers, in this regard, is a more refined and effective policy mechanism than a blanket prohibition on well-established and tested forms of liquidity for insurers.

Additionally, we encourage the Board to broaden its definition of available liquidity to reflect the commensurately wider scope of liquidity sources that can be monetized over a 90-day (versus a more restrictive 30-day) period. For example, we believe that higher quality mortgage-related exposures, with appropriate haircuts, can provide a valuable source of liquidity over a 90-day horizon. The definition should recognize the improved ability, over a 90-day versus 30-day period, for insurers to access the FHLB system as a provider of liquidity against high quality mortgage-backed securities, and both the extended timeline and the limited discount are compatible with the relatively more stable profile of insurer liabilities relative to bank liabilities.

The criteria for liquid assets should recognize that an important dimension of group liquidity risk management is the management of exposure on an entity-basis. To this

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end, it is important to recognize localized jurisdictional aspects of liquidity management. Notably, for activities settled in local currencies, the definition of available liquidity should either recognize local ratings or a modest notching relative to the sovereign rating in determining eligibility. This treatment would promote a tailored approach that aligns with the entity-specific management of liquidity risk inherent in the insurance business model.

We also support the inclusion of reverse repurchase agreements, particularly those secured by highly liquid assets, given their demonstrable reliability as a liquidity source during conditions of stress.

Finally, we believe that the relative differences in the potential volatility of various forms of highly liquid assets are best addressed through appropriately calibrated haircuts. The application of differentiated haircuts, based on the relative volatility under stress of various liquidity forms, is a well-established internal discipline of sound liquidity risk management.

Question 25: What changes, if any, should the Board make to the proposed definition of unencumbered to ensure that assets in the liquidity buffer will be readily available at all times to meet a systemically important insurance company's liquidity needs?

In general, AIG is comfortable with the Board's proposed definition of unencumbered assets; however, we believe that excess collateral pledged to a counterparty, such as FHLB, should be treated as unencumbered.

Question 26: The Board requests comment on all aspects of the proposed liquidity risk-management standard. What alternative approaches to liquidity risk management should the Board consider? Are the liquidity risk-management requirements of this proposal too specific or too narrowly defined?

Question 27: Are the proposed transition measures and compliance dates appropriate? What aspects of the proposed rule present implementation challenges and why? The Board invites comments on the nature and impact of these challenges and whether the Board should consider implementing transitional arrangements in the rule to address these challenges.

Question 28: The Board invites comment on all aspects of the foregoing evaluation of the costs and benefits of the proposed rule. Are there additional costs or benefits that the Board should consider? Would the magnitude of costs or benefits be different than as described above?

AIG believes that transitional arrangements can provide useful additional implementation time for the system and process development that might be necessary to satisfying the standards. Such a transition will also be useful to the Federal Reserve's examination teams, in order to gain greater familiarity with the modal practices and organizational dimensions of insurance liquidity risk management.

We also urge the Board, in its implementation of the liquidity risk management process requirements, to take a pragmatic, risk-focused, tailored approach that:

- Focuses primarily on major legal entities that are most relevant to enterprise liquidity risk exposure;

- Differentiates the assessment of liquidity risk based on the underlying attributes of the exposure, product, or activity; and

- Emphasizes the core analytical processes that are valuable to "business-as-usual" management, provided that the supervised entity can demonstrate the ability and capacity to perform more frequent or tailored assessments as events emerge or conditions change.

To this end, a critical measure of the utility of these standards in addressing the Board's prudential objectives is whether their implementation would satisfy a "use test"; namely, the application should optimally focus on practices that are inherently productive to internal enterprise liquidity risk management.