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Docket No. R-1540
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Comments of the Property Casualty Insurers Association of America
On
Federal Reserve Board's Notice of Proposed Rulemaking (NPR) on Enhanced Prudential Standards for Systemically Important Insurance Companies

The Property Casualty Insurers Association of America represents nearly 1000 insurers and reinsurers that provide coverage throughout the U.S. and around the globe. We appreciate this opportunity to comment on the Notice of Proposed Rulemaking.

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.

The corporate governance and risk management framework provisions appear to assume that all insurance SIFIs must be organized in a top-down or centralized manner, with a single entity-wide risk committee and CRO, and single entity-wide chief actuary (or two if the group writes both life and property/casualty insurance). A number of large insurance groups are not organized in this manner, and should not be forced into this structure even if they are deemed to be systemically important.

The rule is also heavily focused on enterprise-wide implementation, which increases regulatory cost exponentially versus materiality-based regulation. Clear materiality thresholds should be defined covering (1) the frequency, granularity and management oversight/review of cash flow projections; (2) frequency, granularity and management oversight/review of liquidity stress testing results; (3) frequency and granularity of management and independent reviews of stress testing assumptions and methodologies; and (4) granularity of required documentation.

Before promulgation of a final rule, the Board should conduct a detailed cost-benefit analysis, as the proposed liquidity risk-management provisions could be quite resource-intensive and significantly increase costs for insurance SIFIs and their consumers.

Corporate Governance and Risk-Management Standard

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.

The rule should provide that the chair of the risk committee should not have greater fiduciary liability than other members of the Board. This will make it possible to attract potential candidates without the possible penalty of disproportionate liability. The experience required for a risk committee chair should also be more clearly defined.

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?

The rule should provide clearer guidance about the standards to be used to determine whether the compensation provided to the chief risk officer and chief actuary "allows them to objectively assess risk and does not create improper incentives to take inappropriate risks".

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?

As discussed above, the final rule should allow for more decentralized corporate structures as well as for very centralized ones. The rule should at least allow (but not mandate) the position of chief actuary to be split between life and property/casualty operations. Those two businesses are very different in nature and their actuarial practices are very different.

<u>Liquidity Risk-Management Standard</u>

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?

The liquidity requirement should focus on entities that are material to the group, and liquidity analysis should not be required to include or be performed on non-material entities. The cash flow projection, testing, reporting and review requirements of the rule should be limited to liquidity-intensive activities including asset-backed financing and derivatives collateral within material legal entities rather than being applied globally to the entire group. It should be noted that global application of these standards implies "very significant" rather than the "modest" additional regulatory costs cited in the proposed rule.

Requiring a separate senior management approval and review process for new products/activities with liquidity risk is also unduly burdensome. New product/activity processes covering a variety of asset-liability risks (including interest rate, equity, foreign exchange and liquidity risks) should qualify under the Standard.

The proposed rule should also clarify that the cash flow projection requirements are for normal, business-as-usual environments only. Cash flows under stress scenarios are an input into liquidity stress testing requirements.

Projecting cash flow mismatches greater than one year is a highly assumption-driven process that adds little to no value, and should not be required under the rule.

Updating comprehensive short-term cash-flow projections daily and long-term cash-flow projections monthly is unduly burdensome in an environment where most insurance activities incur little liquidity risk. Updating short-term projections monthly and longer-term projections quarterly, with the capacity to update more frequently for liquidity-intensive activities like securities lending and derivatives collateral, is a superior framework.

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?

Senior management review/approval of liquidity stress testing practices, methodologies, and assumptions should generally occur on an annual basis. The quarterly basis outlined in the proposed rule is unduly burdensome.

Question 13 – The Board invites comment 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?

Intraday liquidity management and its associated effects on payments systems is a far more significant responsibility within the banking sector, and no significant value is created by requiring monitoring of intraday liquidity exposures at insurers. The much longer-term nature of insurance liabilities does not generate the same potential requirement for intraday liquidity as does the banking business model.

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?

Liquidity stress testing should focus on the legal entity level for material legal entities.

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 horizon?

The exclusion of financial services obligations from the liquidity buffer reduces the universe of investment grade corporates by about 30%, thereby increasing credit concentration to non-financial issuers in SIFI asset portfolios.

The rule should specifically designate investment-grade structured bonds as highly liquid assets. In general, the rule should specifically designate more assets rather than relying on the "other assets" basket in Section 252.165(b)(3)(i)(H).

Assets qualifying for the 90-day liquidity buffer should specifically include investment-grade agency CMOs, commercial mortgage backed securities and other investment-grade structured assets. High-quality structured assets provide two important systemic protections for large institutional investors, credit diversification and superior liquidity within the 90-day period, including under stressed conditions

Insurance SIFIs should not be required to assume that existing funding sources, including Federal Home Loan Bank borrowings, could not be utilized during a time of stress. The Financial Crisis provides evidence of the FHLB System serving as a resilient source of liquidity in support of its housing mission. Any determination about the ability to obtain new funding or roll-over existing funding should be part of the assessment of each individual stress scenario.

The rule includes a fluid definition of Highly Qualified Liquid Assets (HQLAs) through time that is up to the discretion of the regulator. The combination of fluidity and regulatory discretion sharply increases the likelihood of qualifying assets becoming more restricted during adverse market cycles.

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

Bank deposits should be eligible as highly liquid assets. They are considered to be cash and cash equivalents for all other purposes, including ordinary liquidity management, and are in almost all circumstances an insurer's most liquid assets. They are an insurer's first line of defense against liability outflows. Even in stress situations where banks are under pressure, to assume that insurers will be unable to use any of the cash contained in bank deposits is unreasonable.

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.

The five-quarter phase-in period for both existing and newly-designated SIFIs is too short. In particular, newly-designated SIFIs have a shorter lead-in period to prepare for the standards than original SIFIs prior to the rule becoming official. The short phase-in period significantly raises the implementation cost of the standard versus the multi-year implementation schedule for most systems projects.

Respectfully submitted,

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