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September 16, 2016

BY ELECTRONIC MAIL (regs.comments@federalreserve.gov)

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Re: Advance Notice of Proposed Rulemaking on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities (Docket No. R-1539 & RIN 7100 AE 53)

Dear Mr. Frierson:

The Travelers Companies, Inc. (Travelers) appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System (the Board) advance notice of proposed rulemaking, Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities (the ANPR). Travelers is a leading provider of property and casualty (P&C) insurance products and services to a wide variety of businesses and organizations as well as individuals. Our products are distributed primarily through independent insurance agents and brokers throughout the United States and in selected international markets.

We support the Board's efforts to appropriately tailor a regulatory capital framework to the insurance business. We believe that, for both insurance depository institution holding companies and systemically important insurance companies, the Building Block Approach (BBA) is best suited to meeting the Board's objectives in designing a regulatory capital framework.

We offer the following comments to select questions contained in the ANPR.

Question 1. Are these identified considerations appropriate? Are there other considerations the Board should incorporate in its evaluation of capital frameworks for supervised institutions significantly engaged in insurance activities?

We believe the considerations that the Board identified are appropriate, meaningful and relevant for evaluating a capital framework for supervised institutions significantly engaged in insurance activities. We agree that the capital framework should take into account all material risk-types, be as standardized as possible, be based on U.S. regulatory and accounting standards, achieve a reasonable balance between simplicity and risk sensitivity and be executable in the short-to-medium term.

Question 2. Should the same capital framework apply to all supervised insurance institutions?

We believe a properly designed BBA capital standard can be applied to all supervised insurance institutions. However, additional safeguards may be justified for systemically important financial institutions (SIFIs) such as more involved stress testing or higher loss absorbancy requirements for certain non-insurance risks. We believe the BBA has significant advantages when compared to a consolidated approach (CA) because of the issue of capital fungibility as well as the practical issues related to developing, implementing and maintaining a CA approach.

We cannot overstate the importance of the issue of capital fungibility, or lack thereof, as well as the effect of tax laws on fungibility, in the development of a regulatory capital framework that is tailored for insurance institutions. Fungibility issues include both the level of capital that is not fungible as well as the speed with which capital can be moved, and whether or not local taxes impact fungibility. Where local sector regulatory approval is required to move capital and the capital level in an insurance subsidiary is not sufficiently above the regulatory requirement, then fungibility of that subsidiary's capital is highly unlikely in times of stress. For U.S. insurance entities, state holding company laws place restrictions on the movement of capital out of an insurance legal entity, resulting in capital that is not fully fungible. In addition, if the movement of capital from a subsidiary triggers a current income tax obligation, full fungibility may not exist. The existence of such restrictions for insurance entities and asset movements across national boundaries necessitate a BBA design for all supervised insurance institutions. In contrast, a CA by its nature assumes capital fungibility, which is unlikely to exist in the regulatory and tax framework under which U.S. insurance institutions conduct business.

Question 3. What criteria should the Board use to determine whether a supervised insurance institution should be subject to regulatory capital rules tailored to the business of insurance?

We believe the criteria should be based on whether or not the insurance institution is material to the group from both an economic and risk perspective. From an economic perspective, accounting criteria that may be used as a proxy in such a determination include the significance of the assets and earnings of the insurance underwriting subsidiaries relative to the consolidated assets and earnings, respectively, of the supervised group. We also believe that appropriate consideration should be given to the risks posed to the group by the supervised insurance institution.

Question 5. In addition to insurance underwriting activities, what other activities, if any, should be used to determine whether a supervised institution is significantly engaged in insurance activities and should be subject to regulatory capital requirements tailored to the business mix and risk profile of insurance?

Factors that could indicate whether a supervised institution is significantly engaged in insurance activities include the applicability of insurance regulations and associated regulatory restrictions on capital movements of the insurance institution.

Question 6. What are the advantages and disadvantages of applying the BBA to the businesses and risks of supervised institutions significantly engaged in insurance activities?

We believe that one of the strongest advantages of a BBA approach is that it can be applied to all supervised insurance institutions, including systemically important financial insitutions with insurance operations and insurance institutions with complex organizational structures or product offerings. As noted in our response to Question 2 above, insurance capital is not fully fungible. A BBA model which aggregates legal entity capital across local solvency regimes, recognizes situations where capital is not fully fungible. In contrast, a CA model implicitly assumes full fungibility and can produce misleading results where such fungibility does not exist. For example, a group may appear to be strong on a consolidated basis, but if most of the capital is trapped in a subsidiary where it cannot be accessed in times of financial stress by other subsidiaries in the group, there can be weaknesses that are not visible on a consolidated basis. An advantage of the BBA is that such weaknesses are transparent, whereas a CA would mask these weaknesses.

We believe a BBA can be developed in the short-to-medium term and will be practicable to develop and maintain, as it interacts well with existing regulatory capital regimes. A BBA will also achieve comparability across regimes through scaling, which will require minimal adjustments to existing regulatory regimes. There are a limited number of jurisdictions globally with material volumes of insurance business and for those jurisdictions, scalars appear to be very definable (due to robust data and infrastructures in those jurisdictions). In addition, a BBA can leverage existing regulatory solvency rules and audited financial statements, thus achieving both efficiency and verifiability of underlying data.

The ANPR notes that a key weakness of a BBA is that it would not discourage regulatory arbitrage. We do not believe that regulatory arbitrage is a weakness of the BBA to the extent that capital movements are subject to restrictions, which is the case for U.S. insurance entities. Where capital is analyzed on an entity-by-entity basis in relation to the entity's risks, cash can only be taken from an entity if capital levels are sufficient. The assets in that entity support solely that entity and only in the event of excess capital in that entity would such excess assets support the group. Thus, true regulatory arbitrage opportunities (which rely on capital fungibility in times of stress) are limited.

Another weakness noted in the ANPR is that a BBA would likely require legal entity stress tests. We believe that where capital is not fully fungible (both due to regulatory and tax impacts), legal entity stress tests are appropriate and reflect the limitations placed on the movement of capital with financial groups.

Question 7. What challenges and benefits do you foresee to the development, implementation, or application of the BBA? To what extent would the BBA utilize existing records, data requirements, and systems, and to what extent would the BBA require additional records, data, or systems? How readily *could the BBA's calculations be performed across a supervised institution's subsidiaries and affiliates* within and outside of the United States?

In evaluating the BBA concept, we identified the following challenges, which can be addressed as follows:

- Restatement of non-scalar compatible regimes. Restatement of non-scalar compatible regimes can impose significant operational burdens on insurers for relatively small operations or entities. Because of the immaterial amounts of insurance exposure, these regimes can be excluded without a material impact on the outcome. Refinements can be made over time, including providing a "safe harbor" to treat a material insurance subsidiary under risk-based capital (RBC) via an equity charge if the entity lacks demonstrable recourse to the group.

- Financing structures and transactions. Economically similar financing arrangements may lead to different BBA results due to different structural or accounting regimes. This challenge can be addressed by "looking through" the underlying economics/risks as opposed to following specific accounting rules.

- Scalar calibration for banks under Basil III. Banks' scalars can be calibrated by setting a set percentage of the total capital ratio equivalent to 100% company action level RBC, to reflect the absence of demand deposits and call risks.

- Treatment of holding companies. Because holding companies are not subject to regulatory triggers and do not have typical operating ratios, the application of Basil III is not likely to be appropriate, especially since holding companies generally do not hold demand deposits. This challenge can be addressed by applying the insurance regulatory capital regime to the holding company.

We believe the significant benefits of the BBA outweigh the challenges, of which the latter can be mitigated in short order. These benefits include leveraging existing legal entity capital requirements rather than developing new standards, and utilizing audited financial statement data to support the capital calculations. The BBA greatly reduces the need for maintenance resources as it leverages the analytical efforts of local capital standards which are continually monitored and maintained by local jurisdictions. Maintenance of the BBA model is therefore more easily effected as products, business models and the environments change. Because of these benefits, the BBA is less burdensome and costly to regulators and industry to implement and maintain than other approaches, thus resulting in an approach that can be implemented in the short-to-medium timeframe. In addition, a BBA reflects the group's risks and activities, including those of subsidiaries and affiliates both within and outside the U.S. and those not captured by insurance regulatory capital requirements.

Question 8. What scalars and adjustments are appropriate to implement the BBA, and make the BBA effective in helping to ensure resiliency of the firm and comparability among firms, while minimizing regulatory burden and incentives and opportunity to evade the requirements?

The following adjustments, while not all-inclusive, are needed to appropriately aggregate across a group's entities and activities:

- Elimination of the capital impact of intragroup transactions. This elimination should exclude the impact of investments in affiliates, including surplus notes, from available and required capital of the investing company, and should also exclude capital charges for affiliate loans and guarantees from issuing entities.

- Elimination of state permitted and prescribed accounting practices in order to adjust the accounting basis of U.S. insurance entities to that prescribed by the NAIC. An example would include the restatement of certain life insurance reserves to levels required under NAIC Actuarial Guideline 38 and eventually Principles Based Reserving when the latter is adopted.

- Elimination of any unusual accounting practices allowed or required at the discretion of the applicable supervisor in jurisdictions outside of the U.S.

- Subordinated debt, such as senior notes, typically held at the holding company level is maintained to provide capital resources to the insurance subsidiaries and should be treated as such (see our response to Question 21 below).

Scalars needed to appropriately produce comparable measures of risk which can be aggregated into a group-wide BBA include Basel III, NAIC-qualified jurisdictions, the Canadian Minimum Capital Test for property and casualty companies and Solvency II-equivalent jurisdictions. As noted previously, we believe such scalars appear to be very definable.

Question 9. To what extent is the BBA prone to regulatory arbitrage?

As noted in our response to Question 6 above, we believe that the opportunity for regulatory arbitrage under the BBA is limited to the extent that capital movements are subject to restrictions, as is the case for U.S. insurance entities. In addition, the overall transparency of the BBA model coupled with the adjustments noted above will mitigate the risk of insurers engaging in regulatory arbitrage in order to reduce capital requirements.

Question 10. Which jurisdictions or capital regimes would pose the greatest challenges to inclusion in the BBA?

At this time, we do not anticipate an issue with non-scalable regimes given their relatively small share of the global insurance market. As noted above, we believe there are a limited number of jurisdictions with material volumes of insurance business and all of these regimes are scalable.

Question 11. How should the BBA apply to a supervised institution significantly engaged in insurance activity where the ultimate parent company is an insurer that is also regulated by a state insurance regulator? Are there other organizational structures that could present challenges?

Determining the appropriate treatment of groups with significant non-financial sector operations may be a challenge. Some of the issues and considerations include:

- For holding companies, whether or not the holding company is part of the group (that needs to be kept solvent), or is a resource of the group (that only needs to be looked at as a source of funds/support), with no need to keep it solvent.

- For certain affiliates (e.g., non-US insurers without an "acceptable" regulatory capital requirement), whether or not to assign a 100% capital charge. Assigning a 100% capital charge yields a different capital ratio for the group than an approach that removes the entity entirely from the calculation. Removal assumes that the entity stands on its own and both has no call on other members of the group, and is not being relied upon as a resource for the rest of the group. In some cases the total removal of the investment (which is equivalent to assigning no value to it) may be the better approach for a group capital calculation.

We note that we have heard concerns raised regarding the use of scalars to adjust the regulatory capital requirements of non-US affiliates, as well as concerns with different accounting paradigms that may underlie those capital requirements. We believe this issue may be narrower than many are presuming and that the number of jurisdictions where these issues may actually impact group capital calculations may be very limited. Therefore, resources used to address these concerns may only have to focus on a very limited number of jurisdictions.

Question 12. Is the BBA an appropriate framework for insurance depository institution holding companies? How effective is the BBA at achieving the goal of ensuring the safety and soundness of an insurance depository institution holding company?

Based on the reasons stated in many of our above responses, we believe the BBA is an appropriate framework for insurance depository institution holding companies, especially because the BBA better reflects the group's diverse risks and activities than a CA. Because of the capital fungibility issues noted in our response to Question 2 above, we believe the BBA would be highly effective at achieving the goal of ensuring the safety and soundness of not only insurance depository institution holding companies but systemically important insurance companies as well.

Question 13. Would the BBA be appropriate for larger or more complex insurance companies that might in the future acquire a depository institution?

We are concerned that the criteria discussed to-date has been heavily focused on a group's size (asset levels). Small firms can be complex or have complex risks. Large groups can have simple structures and/or relatively straightforward risks. In addition, asset size can be a flawed measure of insurance risk (e.g., the degree of catastrophe risk for an insurer is not related to its asset size). We recommend a focus on risks rather than on asset size. Notwithstanding that distinction, we believe the BBA would be the most appropriate capital model for insurance institutions that have complex organizational structures, or offer complex products because underlying local regulatory regimes are generally available to capture related risks and appropriate adjustments are either available or can be developed to capture risks not currently included within existing regimes. Unlike the CA model, the BBA approach would better capture the risks of insurance institutions that offer non-homogeneous products across jurisdictions that have different regulatory and legal environments.

Question 14. In applying the BBA, what baseline capital requirement should the Board use for insurance entities, banking entities, and unregulated entities?

For U.S. insurance entities, either the Company Action Level RBC or the level where the trend test applies (e.g., 1.5 times Company Action Level) are potential baseline capital requirements.

Question 15. How should the BBA account for international- or state-regulator-approved variances to accounting rules?

Because of the Board's objective of developing a regulatory capital framework tailored to insurance based on U.S. regulatory and accounting standards, we believe the most appropriate way to account for U.S. state-regulator-approved variances is to adjust such amounts to NAIC-prescribed accounting standards. Similar adjustments should be made to reverse any permitted or prescribed accounting practices that vary from an international jurisdiction's regulatory accounting standards.

Question 16. What are the challenges in using financial data under different accounting frameworks? What adjustments and/or eliminations should be made to ensure comparability when aggregating to an institution-wide level?

The greatest challenge in using financial data under different accounting frameworks would be to develop appropriate risk weights and factors under a CA model. We believe the development of such measures would require substantial analysis and time to complete and maintain. However, even after the development of such risk factors and weights, the CA model would still be fundamentally challenged in cases where capital is not fully fungible.

In contrast, the BBA model can more easily accommodate differences in accounting frameworks with adjustments to NAIC-prescribed accounting standards and reversals of regulatory approved variances in international jurisdictions.

Question 17. What approaches or strategies could the Board use to calibrate the various capital regimes without needing to make adjustments to the underlying accounting?

The Board should consider engaging a qualified consultant as well as the insurance industry in the development of calibration measures. We believe the information and data needed to determine such calibration currently exists and can be used for this purpose.

Question 18. How should the BBA address intercompany transactions?

As noted in our response to Question 8 above, significant intercompany transactions should be eliminated. These would include the impacts of investments in affiliates, including payable and receivables, as well as affiliated reinsurance and intercompany loans and guarantees from the available and required capital of the investing company.

Any intercompany transaction(s) that has the effect of shifting risk from one subsidiary to another within a group, in particular intercompany reinsurance agreements, should be identified and evaluated to understand the impact such arrangements could have on the group's subsidiaries in times of financial stress.

Question 19. What criteria should be used to develop scalars for jurisdictions? What benefits or challenges are created through the use of scalars?

Calibration across various regimes can be accomplished by researching and identifying the capital ratio in a regime for a given financial strength rating. For example, if an A- rated company in regime X typically had a capital ratio of 3, and the same rating in regime Y typically had a capital ratio of 6, then the capital requirements in regime X may be considered to be twice as stringent as those in regime Y.

Question 20. What are the costs and benefits of a uniform, consolidated definition of qualifying capital in the BBA?

The benefit of a uniform definition of qualifying capital is consistency and comparability. However, caution must be applied in developing a uniform definition when differences in a regime's legal and regulatory structure could give rise to different risk profiles of items that may or may not qualify as capital. For example, senior debt issued by U.S. insurance holding companies is typically subject to full subordnation to insurance policyholder obligations, making such debt attractive as a component of an insurer's capitalization structure. Senior debt issued in other jurisdictions may not have similar subordination characteristics and should appropriately be treated differently.

Question 21. If the Board were to adopt a version of the BBA that employs a uniform, consolidated definition of qualifying capital, what criteria should the Board consider? What elements should be treated as qualifying capital under the BBA?

The Board will need to consider jurisdictional differences in regulation and enforcement matters pertaining to the particular financial instrument. For example, because U.S. subordinated debt instruments are fully subordinated to insurance policyholder obligations, the debt should be considered as qualifying capital. Subordinated debt, such as senior notes, is typically held at the holding company level, and debt proceeds are contributed to the insurance subsidiaries and cannot be moved back to the holding company without prior notice or, in many cases, prior approval of the state insurance regulator. In the U.S., these conditions are strictly enforced by regulators and the structural subordination has been upheld by the court systems. However, to the extent certain jurisdictions outside the U.S. treat subordinated debt differently under their regulatory and legal enforcement frameworks, the BBA model could appropriately treat such subordinated debt differently than subordinated debt inside the U.S.

Question 22. Should the Board categorize qualifying capital into multiple tiers, such as the approach *used in the Board's Regulation Q? If so, what factors should the Board consider in determining tiers of* qualifying capital for supervised institutions significantly engaged in insurance activities under the BBA?

We are unclear as to the useful purpose that would be served by categorizing capital ratios into multiple tiers. A single tier ratio can be developed which meets the Board's stated objectives in tailoring a regulatory capital framework for insurance institutions.

Question 23. What are the advantages and disadvantages of applying the CA to the businesses and risks of supervised institutions significantly engaged in insurance activities?

The CA implicitly assumes full fungibility within a financial group, with no tax impact as capital is moved within the group. For the limited circumstances where such fungibility exists, the CA may be a more efficient capital model, but where such fungibility does not exist, the CA masks the limitations on the movement of capital. We believe this is a serious problem for achieving a regulatory capital standard that appropriately captures the risks associated with systemically important financial institutions as well as other supervised institutions significantly engaged in insurance.

Furthermore, the concept of a capital CA model runs contrary to the statutory regulatory and legal entity structural model, whereby states' insurance laws and regulations are constructed such that the individual insurance legal entity must stand on its own. This construct exists across many foreign jurisdictions as well. U.S. statutory accounting standards recognize this regulatory and legal entity structural model and for that reason do not use consolidation accounting for the reporting of an insurance entity's investments in subsidiaries and controlled affiliates, and instead require the use of equity method accounting.

A major disadvantage of the CA will be the need to continually monitor the risk segments and associated risk factors for necessary revisions. Products, business models and environments are not static; any set of risk segments and associated risk factors need to be continually monitored to prevent them from being outdated. In contrast, the BBA leverages local financial sector regulators who have a vested interest in this kind of continual monitoring and capital requirement revision. The local financial sector regulators would also be close enough to their respective markets to anticipate emerging needs for revision, allowing them to quickly adapt or modify their regulatory capital standards.

In addition, as stated previously, we also believe a significant disadvantage of the CA is the timeframe in which a CA can be developed. Given the complexities involved in initially developing a regulatory capital standard, substantial analysis will be required before informed decisions can be made with regard to appropriate risk weights and factors. For these reasons, we believe that a long timeframe will be needed to develop an adequate CA model.

Question 24. What are the likely challenges and benefits to the development, implementation, and application of the CA? To what extent could the CA efficiently use existing records, data requirements, and systems, and to what extent would the CA require additional records, data, or systems?

The extent to which existing records could be used would depend heavily on how the risk segments are defined. If the risk segments match the segmentation available from existing records, then the CA could be applied more efficiently than if the risk segments do not match the segmentation in existing records. As noted in the responses to earlier questions, the maintenance of a CA will be challenging due to the need to continually monitor the risk segments and associated risk factors.

Question 25. To what extent would the CA be prone to regulatory arbitrage?

While not technically considered regulatory arbitrage, the CA may be prone to reliance on assets to support the group that are trapped in one jurisdiction, and are not available to support the group in times of stress. It may encourage the over-leverage or invalid leverage of such assets. Most importantly, the CA could misstate results or risks because of the capital fungibility issues noted previously.

Question 26. Is the CA an appropriate framework to be applied to systemically important insurance companies? What are the key challenges to applying the CA to systemically important insurance companies? How effective would the CA be at achieving the goals of ensuring the safety and soundness of a systemically important insurance company as well as minimizing the risk of a systemically *important insurance company's failure or financial distress on financial stability?*

As noted in various responses to earlier questions, we do not believe the CA would be an appropriate framework for systemically important insurance companies, especially given the capital fungibility issues and the costs of developing and maintaining a CA model. We believe the BBA will be a more transparent and useful regulatory capital standard, as it will allow for easier identification of riskier entities or activities within the group, as well as the regulatory actions, if any, taken by the regulators responsible for overseeing the various subsidiaries of the group.

Question 28. What should the Board consider in developing a definition of qualifying capital under the CA? What elements should be treated as qualifying capital under the CA?

Qualifying capital should be capital available in times of stress. The more detailed any rule regarding qualifying capital, the more likely financial instruments and contracts will be created to circumvent the rule. To avoid this, qualifying capital should be defined via a principle, not a rule.

Question 29. For purposes of the CA, should the Board categorize qualifying capital into multiple tiers? What criteria should the Board consider in determining tiers of qualifying capital for supervised institutions significantly engaged in insurance activities under the CA?

If the principle is that capital should be available in times of stress, it is not clear how there is a benefit from having multiple tiers. There may need to be limits for various types of capital (based on the amount of an asset type that could be relied upon in times of stress), but it is not clear what value having different capital tiers provides.

Question 30. What risk segmentation should be used in the CA? What criteria should the Board consider in determining the risk segments? What criteria should the Board consider in determining how granular or risk sensitive the segmentation should be?

The determination of the risk segmentation is probably best informed by investigation of local financial sector capital requirements. Such requirements are based on risk segments that reflect local conditions and risks, and leverage all the resources that support those local requirements. This points out that the best CA may need to be constructed similarly to the BBA, which raises the question of why two capital approaches are needed rather than just one.

Question 31. What challenges does U.S. GAAP present as a basis for segmentation in the CA?

Segmentation used for U.S. GAAP reporting may not be appropriate for a capital requirement model. Most likely, U.S. GAAP reporting segments will be at too high of an aggregated level as would be appropriate for risk segmentation under a capital model. Therefore, unlike segmentation under a BBA model, which would align with U.S. regulatory reporting segmentation for U.S. insurance subsidiaries and be subject to regulatory scrutiny through various regulatory solvency monitoring tools, segmentation under a CA model would most likely not be subject to the same level of regulatory or auditor scrutiny.

Question 34. Under what circumstances should U.S. GAAP be used or adjusted to determine the exposure amount of insurance liabilities under the CA?

The response to this may be best informed by investigating what is done for local financial sector capital requirements (where the local sector regulator has had a vested interest in obtaining a useful exposure basis).

Question 36. What challenges are there in determining risk factors for global risks?

There will be many local differences which will need to be analyzed in order to determine if a reasonable risk factor can be applied under a CA model.

Thank you for the opportunity to comment on the ANPR. Please feel free to call me at (860) 277-0537 if you have any questions or would like to discuss any of our comments.

Regards,

D. Keith Bell

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