North American CRO Council

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

Dear Mr. Frierson,

The North American CRO Council ("CRO Council") is a professional association of Chief Risk Officers ("CROs") from leading insurers based in the United States, Canada, and Bermuda. Member CROs currently represent 29 of the largest life, and property and casualty ("P&C") insurers in North America. The CRO Council seeks to develop and promote leading practices in risk management throughout the insurance industry, and provide thought leadership and direction on the advancement of risk-based solvency and liquidity assessments.

The CRO Council appreciates the opportunity to comment on the Federal Reserve Board's ("Board") Notice of Proposed Rulemaking ("NPR") on Enhanced Prudential Standards for insurance Systemically Important Financial Institutions ("SIFIs").

The CRO Council recognizes the importance of appropriate corporate governance, risk management, and liquidity risk management standards, and appreciates the Board's efforts to develop such standards that are tailored to the business of insurance. This response letter provides our views on the current proposed standards as they would apply to insurance SIFIs, as per the focus of the NPR. We offer some observations below on the practices required by certain of the proposed standards which would make them more in line with the insurance business model and the need to appropriately manage the associated risks.

Risk Committee, CRO, and Chief Actuary Reporting Requirements

The CRO Council strongly supports the objectives of clear and effective risk governance as a component of a sound ERM function. However, promulgation of prescriptive rules dictating the manner of achieving effective risk governance can be fraught with unintended consequences, and in many cases, may preclude approaches that would yield superior governance results. The CRO Council generally favors the application of sound risk management principles (supported by evidence of achievement of desired outcomes) over blanket adoption of fixed rules.

The Proposed Rule would require an insurance SIFI to maintain an independent risk committee of the board of directors that has, as its sole and exclusive function, responsibility for the risk management policies of the company's global operations and oversight of the operation of the company's global risk management framework. The CRO Council agrees that it is necessary for a systemically important insurer to establish clear and effective risk oversight responsibilities at the board level. However, in our view, clear and effective risk oversight does not necessitate a single risk committee oversight structure. For some insurers, a single or primary risk committee may indeed be the most effective approach, reflecting the business strategy, operating model, governance approach, or enterprise risk profile of the organization. For other insurers, a distributed approach may prove more effective, whereby multiple committees are assigned clearly delineated, but complementary, risk oversight responsibilities that are designed to work in concert.

Regardless of the risk oversight structure selected, a company must be able to demonstrate adherence to sound risk management principles and practices, and demonstrate that their selected approach results in effective board oversight of risk. We believe that the Board's goal of effective board-level risk oversight is laudable, but we have concerns with the Board codifying in regulation any implication that a single risk committee of the board is universally the most effective means for ensuring effective risk oversight.

The Proposed Rule also proposes that the CRO must report directly to the risk committee of the board. The Preamble explains that this reporting structure "provides stature and independence from the lines of businesses and legal entities, which facilitates unbiased insurance risk assessment . . . ". The CRO Council agrees that the CRO must be objective and independent from the lines of business, have appropriate stature within an organization, and have an open and transparent relationship with the board. However, we disagree with the presumption that this must be achieved through a prescribed reporting structure to a board-level risk committee. Most large insurers follow a three lines of defense approach to risk governance (i.e., Business Functions, objective Risk Functions, and independent Internal Audit), which helps ensure sufficient objectivity and independence between lines without prescribing board-level reporting relationships beyond the third line of defense (e.g., Internal Audit). Nonetheless, we support ensuring the CRO has an open and transparent relationship with the Board and any committees thereof deemed necessary to ensure effective governance.

The CRO Council applauds the Board's recognition of the importance of the Chief Actuary role in providing an enterprise-wide view of reserve adequacy across legal entities, lines of business, and geographic boundaries, as well as the role of the Chief Actuary in providing enterprise-level oversight and control with respect to actuarial functions. As the Board notes, the Chief Actuary should ensure that the company's actuarial units perform in accordance with an articulated set of standards that govern process, methodologies, data, and documentation; comply with applicable jurisdictional regulations; and adhere to the relevant codes of actuarial conduct and practice standards.

The CRO Council notes the importance of the actuarial function as a key component of the firm's enterprise-wide control framework with respect to the assumptions, methods, and models which underlie actuarial calculations, where these actuarial controls are supported by rigorous actuarial professional codes and standards, and financial reporting standards.

While we agree with the recognition of the Chief Actuary in enterprise-level actuarial oversight and that the Chief Actuary should have clear and transparent access to the board of directors, we believe it is important to avoid over-prescription in the requirements of the Chief Actuary. In particular, the Board proposes that the Chief Actuary must report to the audit committee of the board of directors on the level of reserves. We believe the standards should permit the Chief Actuary the flexibility to report to the board of directors and/or appropriate board-level committees, such as the finance committee, on the level of reserves.

Considering the proposed standards with respect to delineation between the Chief Actuary and Chief Risk Officer roles, the CRO Council understands the desire to delineate these roles more clearly and consistently for SIFIs. Depending on the size, activities, and structure of an insurance company, however, it may be reasonable and appropriate for the same individual to hold both roles. Indeed, this is in practice for a significant number of insurance companies in the United States. The historical and current practice by some firms, including SIFIs and large, complex insurers, of a single officer serving as both Chief Actuary and Chief Risk Officer further underscores the critical role of the actuarial function and the oversight it performs in the insurance company's enterprise risk framework. Through the application of the aforementioned three lines of defense construct, a greater level of comfort can be achieved over the reporting lines and shared responsibilities of the Chief Risk Officer and Chief Actuary. Ultimately, the overall focus for the Chief Actuary and Chief Risk Officer roles should be based on effectiveness and outcomes, which may be at times best achieved by having a single officer serving both roles, and may be reflected in different means of ensuring appropriate stature within an organization to effectively challenge and influence risk-based decisions.

Liquidity Risk Management

Liquidity risk management is an important aspect of a firm's overall risk management framework, and the CRO Council is supportive of liquidity risk management principles and standards which are appropriately tailored for insurance. We note several areas of concern with respect to the current proposed standards as they would apply to insurance SIFIs, and furthermore to any insurance company. Our concerns stem from the lack of sufficient tailoring of the Board's current liquidity risk management standards which apply to banks, and the overly-prescriptive nature of the proposed standards. Furthermore, the CRO Council feels that there needs to be appropriate consideration and tailoring for life and P&C insurance companies to reflect the significant differences between them.

In considering these concerns, we feel it is important to note that liquidity risk is a far less significant risk for insurance than for banking. First, run risk, which is a primary source of liquidity strain for banks, is generally not associated with insurance. Life insurance liabilities are highly stable, with low turnover, and generally long-term, unlike bank demand deposits which are prone to mass run risk.

The surrender of an insurance policy may be entirely counter to the best interest of the policyholder given the resulting loss of insurance coverage (which may be more costly or impossible to replace), and the significant cost in the form of surrender charges and potential tax implications. In addition, legal/contractual protections prevent immediate surrender/payout of surrender values for insurance contracts. Given the long-term and stable nature of a life insurer's liabilities and the "buy and hold" investments which support them, the overall risk profiles of large life insurers are relatively stable over time, and life insurance companies manage their risks in a manner aligned to, and reflective of, this profile. P&C insurance companies, with their predominately short-duration contracts (and often having a significant lag between premium receipt and payment of claims), effectively manage these reasonably predictable cash-flows, notwithstanding the uncertainty in the emergence of liabilities themselves. These fundamental aspects of the insurance business model demand appropriate recognition in the development of liquidity risk management principles and standards. While certain activities performed by insurers may mirror those of banks or other financial institutions, such as derivatives trading or securities lending, the prudent approach to addressing liquidity risk associated with those activities is through appropriate standards *for those activities*.

The CRO Council believes that cash-flow projection standards should be adapted for life and P&C companies separately based on the significant differences in their respective insurance contracts. For life insurance companies, the CRO Council believes that updating insurance cash-flow projections on a monthly basis would be sufficient to manage short-term liquidity risk. Requiring short-term insurance cash-flow projections on a daily basis would be extremely onerous and would not provide meaningful value toward managing liquidity risk for an insurer. Correspondingly, the CRO Council believes that producing long-term life insurance cash-flow projections quarterly, on the same cycle as comprehensive liquidity stress testing (discussed below), would be sufficient to manage long-term liquidity risk, and that there would be insufficient value to justify the requirement for projections to be produced more frequently. For P&C insurance companies, contracts are usually not longer than a year in duration and do not include significant investment components. Cash-flow management for P&C companies should be focused on the nature of the company's business, investment profile, and exposure to risk (e.g., the potential cash draw of a large natural catastrophe). The cash-flow profile for P&C companies is not significantly tied to the financial markets and does not change as frequently, and as such, updating insurance cash-flow projections monthly would not provide business value.

The CRO Council believes that the frequency and horizon of liquidity stress testing should be aligned with the liquidity of the liability, and reflect the very different nature of life and P&C liabilities. Given the profile of the liabilities for P&C insurance companies, stress testing could be conducted on a quarterly or semi-annual basis.

Given the stability of the life insurance risk profile (i.e., insurance risks generally don't change drastically in the short-term), we believe that comprehensive liquidity stress tests should be performed on a quarterly, or semi-annual (rather than monthly) basis. To the extent that insurers have activities that are supported by liabilities that are shorter-term and capital-market sensitive in nature, more frequent projections and shorter durations may be appropriate. These would be performed on an activities basis, versus a comprehensive enterprise-wide level.

Overall, more frequent projections and shorter horizons may be appropriate for certain kinds of activities (e.g., derivative hedge programs), and monitoring of these could be incorporated into ongoing supervisory programs. However, even for these activities, intraday liquidity monitoring is not typically relevant for insurers. Thus, the CRO Council supports intraday liquidity monitoring procedures only "if necessary for its business." Such an approach appropriately recognizes that insurers do not generally engage in activities which demand intraday monitoring. Furthermore, the CRO Council believes that it is inappropriate to consider cash held at banks and other financial institution securities as illiquid for stress testing purposes. Cash deposits held at banks (including demand and time deposits and certificates of deposit ("CDs")) should be eligible for inclusion in the liquidity buffer. Insurers hold such deposits for the very purpose of having a reliable source of immediate liquidity. Their exclusion would create an incentive for insurers to replace cash with less liquid investments, increasing liquidity risk. Other assets which should be recognized in a liquidity buffer for stress testing include Money Market Fund shares, certain fixed income instruments, and asset-backed/mortgage-backed securities which meet the spirit of the Board's "liquid and readily marketable" criterion.

In conclusion, the CRO Council supports the Board's aim to develop appropriate Enhanced Prudential Standards for insurance SIFIs, but urges the Board to further tailor the standards in order to ensure appropriateness for insurance, including the distinction between life and P&C insurance, and to avoid creating perverse consequences. While the standards are defined for insurance SIFIs, we nonetheless wish to express caution against the Board, or any interested party, viewing these standards as universally appropriate or applicable to insurance. The CRO Council would also offer as a general consideration that, given the wide array of business models, risk profiles, and operations that are represented, both in the organization and across the industry, standards should not be overly prescriptive, but rather should focus on effectiveness and outcomes, be proportionate, and consider materiality.

Sincerely,

Stephen Gruppo, Chair
North American CRO Council