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October 23, 2017

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

Re: Banking Organization Systemic Risk Report Form Modifications

Dear Ms. Misback:

We greatly appreciate the opportunity to share our views on the proposed modifications[1] to FR Y-15, the mandatory Banking Organization Systemic Risk Report Form. The proposed modifications could negatively impact the clearing and costs of over-the -counter ("OTC') derivatives for end-users like life insurance companies.

The American Council of Life Insurers ("ACLI") is a national trade association representing 290 life insurers that hold over 95 percent of the industry's total assets. Our members serve 75 million American families that rely on life insurers' products for financial and retirement security. Our members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance. Life insurers hedge asset and liability risks with derivatives, and have actively participated in the important regulatory dialog leading to implementation of Title VII of the Dodd-Frank Act[2] concerning derivatives regulation.

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[1] 82. Fed. Reg. 163 at 40154 (Aug. 24, 2017) https://www.gpo.gov/fdsys/pkg/FR-2017-08-24/pdf/2017-17939.pdf

[2] For example, ACLI submitted detailed comments on the following related and parallel regulatory proposals developed by the U.S. Prudential Regulators, the U.S. Commodity Futures Trading Commission ("CFTC"), and the U.S. Securities and Exchange Commission ("SEC") governing margin and capital requirements:

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities; [http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf] [Prudential Regulators];
- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared Swap Transactions for Swap Dealers and Major Swap Participants [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson] [CFTC];
- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson] [CFTC];
- SEC proposal on margin, capital and segregation for security-based swap dealers and major security-based swap participants [http://www.sec.gov/comments/s7-08-12/s70812-25.pdf]; and,
- Request for Comments on Reproposed Rule for Margin and Capital Requirements for Covered Swap Entities [http://www.federalreserve.gov/SECRS/2015/January/20150127/R-1415/R-1415_112414_129786_278794149594_1.pdf].

ACLI also submitted comments on the initial BCBS-IOSCO Consultative Document for Non-Centrally Cleared Derivatives, published by the Basel Committee on Bank Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) (May 2012) ("BCBS-IOSCO Consultative Paper") [http://www.bis.org/publ/bcbs226/acoli.pdf]

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The Board of Governors of the Federal Reserve System ("Board") invited comment on its proposal to extend, with revision, the mandatory Banking Organization Systemic Risk Report (FRY–15; OMB No. 7100–0352). The initiative's proposed modifications will affect the treatment of client-cleared OTC derivatives transactions for purposes of the capital surcharge (the G-SIB Surcharge") imposed on U.S. globally systemic important banking organizations (G-SIBs").

The proposed modifications reflect significant policy changes and could considerably enlarge G-SIB Surcharge capital requirements unless an affected G-SIB contracted its OTC derivatives central clearing activities. While the proposal directly affects G-SIBs, it could also inflict substantial burdens indirectly on end-users, increase systemic risks, and impair cleared derivatives markets. Regrettably, the extremely brief Federal Register notice does not address this negative collateral impact or provide explanatory reasoning for the change. Promulgating significant policy changes through revised reporting form instructions is not adequate. The initiative fails the essential requirements of the Administrative Procedure Act ("APA") for rule changes, and neglects required cost benefit analysis for federal agency rulemaking.

Accordingly, we recommend that the Board withdraw the proposal to properly address its profound collateral impact. If the policy modifications proceed forward, they should be done deliberatively under APA rulemaking standards and not obscured in revised instructions to a reporting form with little explanation.

Life Insurers' Interest in the Proposed Reporting Form Modifications

Life insurers use of the OTC derivatives markets to protect their assets and to hedge risks inherent in the policies and products they issue to their customers. Life insurers' use of derivatives is carefully and prudently regulated by state-level insurance departments acting pursuant to state law and regulation. These laws and regulations uniformly prohibit life insurers from using derivatives as a means of speculation or proprietary trading. In short, life insurers are key "end users" of derivatives.[3] Rule changes that affect banks' regulatory and market expenses often translate into increased transactional costs for life insurers, and reduced marketplace liquidity or stability.

Life insurers are significant institutional investors that have a major role in U.S. capital formation and the U.S. economy. Life insurers' assets supporting fixed insurance products ($4.25 trillion) and variable insurance products ($2.52 trillion) reflect a substantial percentage of the U.S. equities and bond market. Life insurers' assets are invested in corporate bonds (33%), stocks (31%), government bonds (8%), commercial mortgages (6%), and other assets (22%). Life insurers are the largest institutional investor in U.S. corporate bond financing. Approximately 49% of life insurers' $6.7 trillion total assets in 2016 were held in long-term bonds, and over 38% of corporate bonds purchased by

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[BCBS-IOSCO], and the BCBS-IOSCO Second Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives (Feb. 2013) ("Second BCBS-IOSCO Consultative Paper") [http://www.bis.org/publ/bcbs242.pdf].
On August 4, 2015, ACLI filed comments on the Prudential Regulators' net stable funding ratio proposal. finalized by the Basel Committee on Banking Supervision as part of Basel III, as Regulatory Agencies were considering a similar proposal for entities under their authority.

On July 5, 2016, ACLI filed comments on the BCBS Revised Basel III Leverage Ratio Framework-Consultative Document published April 25, 2016. The submission explained that life insurers are among the financial end users affected by the leverage ratios under consideration in the Consultative Document. ACLI previously filed a submission dated September 20, 2013, with the Basel Committee on Banking Supervision (BCBS) on its initial consultative document that proposed a revised Basel III leverage ratio framework through a supplementary measure of the Risk Based Capital ("RBC") requirements for Banks.

[3] Background on life insurers use of derivatives can be found in the National Association of Insurance Commissioners Capital Markets Special Report: Update on Insurance Industry*'s Use of Derivatives and Exposure Trends* (Aug. 16, 2017) http://www.naic.org/capital_markets_archive/150807.htm .

life insurers have maturities exceeding 20 years (at the time of purchase).[4] Life insurers, therefore, are one of the principal sources of long-term corporate financing, and have an important impact on the U.S. economy. Unreasonable costs and burdens of rulemaking can, therefore, have a negative impact on life insurers' contributions to capital formation. The proposal, therefore, greatly affects life insurers and warrants a clearer, more deliberative regulatory process.

Statement of Position

We have reviewed a submission on the proposal by ISDA and the Futures Industry Association dated October 11, 2017. We support the observations, conclusions and recommendations in that letter and incorporate them by reference herein. As noted in the submission, the Board should not make major policy revisions to G-SIB surcharge calculations through modifications to the information reporting form. Any modifications to G-SIB surcharge calculations need thorough explanation and careful evaluation of the proposal's impact on G-SIBs, end-users, cleared derivatives markets, and systemic stability. The Board should not adopt the proposal. If it is to proceed forward, a formal rulemaking under the APA with notice and opportunity for comment must be provided. The Board needs to fully explain the proposal's rationale and conduct a complete cost-benefit analysis as explained below.

As noted in the ISDA-FIA letter, the significant and disproportionate capital burden under the proposal may lead to departures of clearing members from the market. Likewise, profound increases in clearing members' required capital could result in enlarged costs for end-users, like life insurers, that use derivatives to manage asset and liability risks. The proposal could also impair the liquidity and portability of cleared derivatives markets. All of these outcomes would counterproductively increase systemic risk.

Because life insurers' primary use of derivatives is for hedging the risks associated with their investments portfolios and insurance and annuity product liabilities, the general impact of the proposed approach would burden the insurance industry's ability to manage and hedge financial risk. These collateral consequences are contrary to overall stability in the derivatives marketplace.

Administrative Procedure Act Considerations

- **APA Rulemaking Required**

The proposal would generate a significant policy change to existing regulatory standards. A formal rulemaking with thorough explanation of the initiative's purpose and implications, including a cost-benefit analysis, are fundamental and necessary. The inadequate, short explanation of the proposal's purpose and implications fails these fundamental APA requirements. Being simply captioned as modifications to an informational form disguises the radical changes the proposal would inflict on G-SIB Surcharges. Many commentators and interested parties may have innocently overlooked the significant effective rule changes the proposal would impose. There is no regulatory urgency to race forward with the proposal. A formal APA rulemaking is the proper course of action.

- **Executive, Statutory and Judicial Mandates for Federal Agency Cost-Benefit Analysis**

[4] These calculations are based on data from the 2016 NAIC Annual Statement Data and ACLI calculations based on and the U.S. Federal Reserve Board, Flow of Funds Accounts of the U.S.

Congress, courts, and the executive branch of government have issued unequivocal guidance mandating thorough, objective cost-benefit analysis in rulemaking. Collectively, these standards ensure that federal agencies "strike the right balance," and develop "more affordable, less intrusive rules to achieve the same ends--giving careful consideration to benefits and costs."[5]

Executive branch mandates for cost-benefit analysis began in 1981 with Executive Order 12,291 that created a new procedure for the Office of Management and Budget (OMB) to review proposed agency regulations, and ensured the president would have greater control over agencies and improve the quality and consistency of agency rulemaking. Cost-benefit analysis formed the core of the review process. The order unambiguously stated that "regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society."[6] Regulatory agencies, therefore, must balance the benefits of proposed rules against their costs.

In 1993 Executive Order 12,866 superseded the 1981 order, but retained cost-benefit analysis as a fundamental requirement in rulemaking. Executive Order 12,866 instructs that "in deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating."[7] In a manner parallel to the 1981 order, Executive Order 12,866 advises that agencies must perform their analysis and choose the regulatory approach that maximizes net benefits.[8]

President Obama reaffirmed the importance of cost-benefit analysis in 2011 through Executive Order 13,563, and reinforced the core principles in Executive Order 12,866 by emphasizing that "each agency must . . . propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs."[9] Importantly, five administrations between 1981 to present have consistently made cost-benefit analysis a threshold for federal agency rulemaking.

The OMB provided federal agencies with extensive guidance to perform cost-benefit analysis in its Circular A-4.21 C[10], which identifies three fundamental elements to federal agency rulemaking: (i) a statement of the need for the proposed regulation; (ii) discussion of alternative regulatory approaches; and, (iii) an analysis of both qualitative and quantitative costs and benefits of the proposed action and the leading alternatives. The analysis should attempt to express both benefits and costs in a common measure—monetary units—to facilitate the assessment. When benefits or costs cannot be quantified

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[5] Op-Ed, President Barak Obama, Toward a 21st Century Regulatory System, Wall Street Journal (Jan. 18, 2011). The President's Op-Ed coincided with his issuance of Executive Order 13,563, which set strict standards for cost-benefit analysis in federal agency rulemaking.

[6] 46 Fed. Reg. 13193, 13193 (Feb. 17, 1981).

[7] Exec. Order No. 12,866, 3 C.F.R. 638 (1993).

[8] The 1981 and the 1993 executive orders emphasize different approaches to the same cost –benefit end. The 1981order required that the benefits "outweigh" the costs, while the 1993 order required only that the benefits "justify" the costs. See generally Peter M. Shane, Political Accountability in a System of Checks and Balances: The Case of Presidential Review of Rulemaking, 48 ARK. L. REV. 161, 176-78 (1994) (comparison of 1981 and 1993 executive orders with additional detail and observing that the 1993 "order focuses on a similar mandate, but describes it with greater nuance").

[9] Exec. Order 13,563, § 1(b), 76 Fed. Reg. 3821 (Jan. 18, 2011). The order further notes that "each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible." Additional analysis of this order can be found in Helen G. Boutrous, Regulatory Review in the Obama Administration: Cost-Benefit Analysis for Everyone, 62 ADMIN. L. REV. 243, 260 (2010).

[10] Office of Mgmt. & Budget, Circular No. A-4, Regulatory Analysis (Sept. 17, 2003), last available at http:// www.whitehouse.gov/OMB/circulars/a004/a-4.pdf. OMB invited full public comment on his 48-page circular in draft form, which contains detailed instructions about conducing cost-benefit analysis, and provides a standard template for running the analysis.

in monetary terms or in some other quantitative measure, the agency should describe them qualitatively.[11]

The Administrative Procedure Act (APA) provides comprehensive standards governing federal agency rulemaking, and includes guideposts for judicial review of agency rulemaking under an arbitrary and capricious threshold. The Regulatory Flexibility Act (RFA) of 1980 (5 U.S.C. §§601-612) requires federal agencies to assess the impact of their forthcoming regulations on "small entities," which the RFA defines as including small businesses, small governmental jurisdictions, and certain small not-for-profit organizations. Under the RFA, cabinet agencies must prepare a "regulatory flexibility analysis" when final rules are issued. The RFA requires the analysis to describe, among other things, (1) reasons why the regulatory action is being considered; (2) small entities to which the proposed rule will apply and, where feasible, an estimate of their number; (3) projected compliance burdens of the proposed rule; and (4) any significant alternatives to the rule that would accomplish the statutory objectives while minimizing the impact on small entities.

In a trilogy of three significant cases involving SEC rulemaking beginning in 2005, the U.S. District Court for the federal circuit overturned major rules due to the SEC's failure to conduct adequate cost-benefit analysis which the court viewed as arbitrary and capricious actions contrary to the mandates of the APA.[12] The holdings depart from the court's traditionally more deferential approach to review of agency rulemaking in other administrative law contexts and provide a template for measuring appropriate cost-benefit analysis in federal agency rulemaking. These three rulings are significant because they were rendered by the federal court that typically reviews agency actions and, thus, serves as a touchstone for appropriate federal rulemaking in general. Additionally, the rulings provide an avoidable roadmap to litigation for insufficient cost-benefit analysis in rulemaking. In sum, therefore, the guidance established by statutes, executive Orders, and seminal recent court cases strongly warrant a more carefully balanced and detailed cost-benefit analysis before the proposal moves forward.[13]

The proposal's exposure to post-adoption legal challenges can be mitigated. In the end, the proposal should fully evidence the line of Executive Orders discussed above.

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[11] To ensure that agencies properly perform cost-benefit analysis and select the most cost-effective regulatory options, OMB and the White House Office of Information and Regulatory Affairs (OIRA) review agency cost-benefit analysis before proposed regulations become effective.

[12] See Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005), Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166 (D.C. Cir. 2010), and Bus. Roundtable & U.S. Chamber of Commerce v. SEC, 647 F.3d 1144 (D.C. Cir. 2011). In the Business Roundtable and US Chamber of Commerce case, the D.C. Circuit overturned proxy access Rule 14a-11 adopted by the SEC in August 2010. The court determined that the SEC's failure to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation" made promulgation of the rule arbitrary and capricious and not in accordance with law. The American Equity case involved the SEC's adoption of Rule 151A under the Securities Act of 1933 which provided guidance as to whether fixed index annuities were entitled to rely on the exclusion provided under Section 3(a)(8) of that act. The court indicated that the SEC did not disclose a reasoned basis for its conclusion that Rule 151A would increase competition and the SEC did not make any finding as to existing level of competition in the marketplace under state insurance law regimes or the efficiency of existing state insurance law regimes. The Court remanded Rule 151A back to the SEC for "reconsideration," solely because it found that the SEC had not given proper consideration to the rule's effect on "efficiency, competition, and capital formation" in the annuity industry.

[13] See generally Peter M. Shane, Political Accountability in a System of Checks and Balances: The Case of Presidential Review of Rulemaking, 48 ARK. L. REV. 161, 176-78 (1994).

Conclusion

For the reasons stated above, we recommend that the Board withdraw the proposal. If the Board determines to advance the modifications to G-SIB Surcharges, then a new rulemaking proposal with a thorough explanation of its purpose and implications, with a fulsome cost-benefit analysis, is the best course of action.

We greatly appreciate your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

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