ACLI
Financial Security...for Life.

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October 12, 2012

The Honorable Thomas J. Curry
Comptroller
Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, S.W.,
Washington, DC 20219

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20551

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW.
Washington, DC 20551

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (FRS Docket No. R-1438 & RIN 3064-AD95); Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (FRS Docket No. R-1442 & RIN 3064-AD96); Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule (FRS Docket No. R-1442 & RIN 3064-AD97)

Dear Sirs:

These comments are submitted on behalf of the American Council of Life Insurers (the "ACLI"). The ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. We appreciate the opportunity to submit comments to the Federal banking agencies (the "Agencies") on the three notices of proposed rulemaking that would implement the Basel III capital framework in the United States (the "Proposals").[1]

Our comments are presented in two parts. Part I is a discussion of insurer risk-based capital requirements and the appropriateness of applying those requirements as the primary measure for any prudential standards for a holding company that is primarily an insurance enterprise. Part II responds directly to the three notices of proposed rulemakings ("NPRs") referenced above.

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[1] Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012); Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (Aug. 30, 2012); Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule, 77 Fed. Reg. 52,978 (Aug. 30, 2012).

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I. Insurer RBC Requirements are the Appropriate Prudential Standard to Apply to an Insurance Company Enterprise

At the outset, we wish to make clear that the ACLI strongly supports appropriate rules intended to ensure the capital adequacy of insurance companies. To that end, and contrary to commentary contained in the Second NPR (the "Standardized Approach NPR"),[2] the ACLI unequivocally believes that the current insurer risk-based capital system ("RBC") is best suited to measure the capital needs of insurance companies and is therefore best suited to also meet the needs of the Board of Governors of the Federal Reserve System (the "Board") when it assesses the capital adequacy of insurance company enterprises under these proposals. RBC was specifically designed by insurance regulators for insurance company entities and is a holistic and comprehensive measure of their unique risks.

The foundation of RBC is statutory accounting where both assets and liabilities are valued conservatively. This results in an appropriately prudent measure of surplus as the starting point for the RBC calculation. Statutory accounting also takes a long-term oriented asset/liability matching posture that appropriately incents companies to invest for the long term. It intentionally avoids application of fair value accounting rules to most life insurance company assets, thereby avoiding unwarranted volatility in regulatory capital. Such short-term volatility is usually inappropriate, particularly for life insurers that typically have long-term and inherently stable liability structures.

RBC also recognizes the unique characteristics of insurance companies' business models and balance sheets, which are very different from those of banks. Specifically, it recognizes that premiums are collected in advance and invested ahead of anticipated claims, that insurers have relative predictability of those claims, and that products have safety mechanisms such as surrender charges to protect against illiquidity. Unlike banks, which are typically exposed to large amounts of highly liquid demand deposits, insurers have longer-term liabilities and therefore find that longer-term assets, even those with higher short-term volatility, can often pose less risk and be a key component to the long-term viability and financial strength of an insurer.

In addition to capturing credit risk of fixed income investments and the risk of fair value losses from equity (and similar) investments, RBC also captures many other risks, such as asset risk, insurance/underwriting risk, interest rate risk, and business risk, as well as differentiating between insurance industry structures (life, P&C, and health). Over the past 20+ years, RBC has been and continues to be repeatedly reviewed and refined, reflecting changing conditions and increasing sophistication of modeling techniques. RBC, along with other regulatory tools, has proven effective in limiting insolvencies and preserving financial strength, as was highlighted during the recent financial crisis. According to the Financial Stability Oversight Council's ("FSOC") 2011 report, just 28 of approximately 8,000 insurers became insolvent in 2008 and 2009.[3]

Further, all U.S. insurance companies currently prepare statutory accounting statements, as is required by law, whereas many life insurance companies do not prepare GAAP-based financial

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2 Standardized Approach NPR, 77 Fed. Reg. 52,928.

3 Financial Stability Oversight Council, *2011 Annual Report*, Pg. 61. On page 58, the FSOC 2011 Annual Report also states that: "...as the crisis has unfolded, 370 bank and thrift failures occurred through June 30, 2011, or 4.5 percent of institutions operating at the beginning of 2008". During that same time 0.35% of insurers became insolvent.

statements. Requiring GAAP-based financial statements coupled with a bank-centric capital adequacy regime would unnecessarily result in an additional and competing set of financials and capital measures for many companies.

RBC in concert with other risk metrics appropriate to life insurance companies such as economic capital and risk appetite is widely used by management, rating agencies and others as a measure of an insurer's overall risk, and as a measure of its overall financial strength as compared to actual capital. The ACLI believes leveraging RBC is appropriate for the Board to best measure the capital adequacy and risks inherent in insurance operations. It also helps to avoid having insurance companies manage two different (and potentially competing) capital requirement paradigms. Utilizing a more bank-centric capital metric could result in decisions that may not be in the best interests of insurers' investors and policyholders, who may be investing in an insurance company to specifically take advantage of a longer-term investment horizon. In fact, the Board's apparent insistence that life insurers invest on a more short-term basis (as bank-centric parameters require) necessarily creates an inappropriate asset-liability mismatch.[4] In contrast, the ACLI proposes a straightforward methodology that leverages RBC for insurance operations yet provides a consolidated capital metric that best serves both the Board and insurance companies with banking/thrift operations (or, as noted in footnote 5 of this commentary, which may be designated as systemically significant). A summary of that methodology is included as an attachment in Appendix AA.

In addition, RBC is further supported by the conservative reserving for liabilities that state insurance law requires. Insurance reserves that are calculated as required for statutory accounting perform part of the function that capital performs for banks. Insurance reserves are set to absorb moderately adverse financial experience, which is a typical purpose of capital. For example, the capital-like character of certain reserves is demonstrated in the bank capital model by the adding back of the Allowance for Loan Loss Reserves in the Tier 2 capital calculation.

Finally, we believe there exists statutory authority for the Board to recognize insurer RBC as a methodology that can be used to meet the requirements under Section 171 of the Dodd-Frank Act. Section 171 provides that the risk based and leverage capital requirements "shall not be less than" nor "quantitatively lower than" the generally applicable minimum requirements under Basel III. This language clearly empowers the Board to deem the insurance RBC framework and action levels as equivalent to the bank prompt corrective action regime so long as they are not "less than" nor "quantitatively lower than" the minimum bank risk based and leverage capital requirements. Such equivalence is not only appropriate given the asset/liability mix of insurers as well as the longer liabilities insurers hold relative to banks, it recognizes a superior mechanism for assessing an insurer's financial position. The language of Section 171 itself provides evidence that Congress did not intend that bank-centric capital requirements be imposed on appropriately regulated insurance companies, and we urge the Board to use this authority to develop an appropriate methodology for insurance entities utilizing insurer RBC.

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4 It is important and relevant to note that asset/liability "Maturity Mismatch" is one of the six categories under the Financial Stability Oversight Council's (FSOC) analytic "Framework" that will be used to determine if a financial entity should be designated as systemically significant (*12 CFR Part 1310 – Appendix A*, 77 Fed. Reg. 21659). The Board's position on this issue with respect to insurers as evidenced by the Proposals is in direct conflict with the FSOC pronouncement that such asset/liability "Maturity Mismatch" should be minimized throughout the financial system.

II. Response to the Basel III Capital Framework Proposals

A. Introduction

As discussed above, we strongly believe that the current RBC system for insurers is the best framework for measuring the capital adequacy of insurance companies and insurance groups, and is therefore best suited to meet the Board's needs when it assesses the capital adequacy of insurance company enterprises under the Proposals. We therefore strongly believe that the Board and the Agencies should not seek to apply, even in modified form, a capital framework based on Basel III to bank holding companies ("BHCs") or savings and loan holding companies ("SLHCs") that are predominantly insurance enterprises. To illustrate our point, this letter includes discussions of several examples of the many fundamentally poor fits of the proposed capital rules to insurance companies. We offer the following specific comments with respect to the Proposals.[5]

The Proposals consist of three NPRs. The first NPR (the "Basel III NPR") proposes changes to the existing U.S. risk-based capital and leverage capital requirements to incorporate changes made by the Basel III agreement. The Standardized Approach NPR proposes revisions to the existing U.S. risk-based capital requirements for determining risk-weighted assets to incorporate *inter alia* certain international standards from the standardized approach in the Basel III agreement. The third NPR (the "Advanced Approaches NPR") proposes revisions to the existing U.S. advanced approaches capital rules to incorporate *inter alia* certain aspects of the Basel III agreement applicable to advanced approaches banking organizations. The proposals in the Basel III NPR and the Standardized Approach NPR would apply to all banking organizations currently subject to minimum capital requirements under existing U.S. rules as well as to top-tier SLHCs domiciled in the United States. The proposals in the Advanced Approaches NPR would apply to existing advanced approaches banking organizations as well as to SLHCs that meet the applicable thresholds set forth in the advanced approaches rules. A number of insurance companies are SLHCs by virtue of their ownership of savings associations. The proposed application of a bank-centric capital regime in the form of Basel III to SLHCs that are predominantly insurance enterprises raises significant issues that we address in this letter.[6]

The practicality, and indeed even the wisdom, of imposing on the banking system a set of new capital standards as complex as the Basel III capital framework is now being broadly questioned by regulators and experts alike.[7] These regulators and experts have provided compelling arguments as

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5 The comments and arguments in this response are made equally on behalf of all BHCs and SLHCs that have significant insurance activities in their consolidated organizations. The term "BHCs and SLHCs that are predominantly engaged in insurance activities" also includes all BHCs and SLHCs that are insurance companies and directly or indirectly own one or more insured depository institutions.

6 Although our comments focus primarily on BHCs and SLHCs that are predominantly insurance enterprises, many of the same issues are relevant to any insurer that might be designated as systemically important by the FSOC under Title I of the Dodd-Frank Act. Under section 171 of the Dodd-Frank Act, commonly known as the "Collins Amendment," any nonbank financial company designated as systemically important would be subject to the generally applicable risk-based and leverage capital requirements contemplated by the Proposals, regardless of whether the nonbank financial company is affiliated with an insured depository institution.

7 *See, e.g.*, Andrew Haldane, Executive Director, Bank of England, Speech at the Federal Reserve Bank of Kansas City Economic Policy Symposium: The Dog and the Frisbee (Aug. 31, 2012), *available at* http://www.kansascityfed.org/publications/research/escp/escp-2012.cfm; Thomas M. Hoenig, Director, FDIC, Speech to the American Banker Regulatory Symposium: Back to Basics: A Better Alternative to Basel Capital Rules (Sept. 14, 2012); *available at* http://www.fdic.gov/news/news/

to why the Basel III capital framework even as applied to banks (for which it was designed) will at best prove unworkable and at worst harmful. These parties are soberly counseling the banking authorities to rethink the entire Basel III framework. We respectfully submit that if there are design flaws (as these regulators and experts assert) in the Basel III framework as applied to banks, there are *a fortiori* even more fundamental problems in applying the Basel III framework to entities that are predominantly insurance enterprises.

1. Applying the Basel III Capital Framework to Insurers

The Board has chosen in the Proposals to impose consolidated quantitative capital requirements on SLHCs for the first time. In the preamble to the Standardized Approach NPR, the Board states that with the release of its Notice of Intent in April 2011[8] it signaled the possibility that it would apply to SLHCs the same consolidated risk-based capital requirements as those proposed for BHCs. Notwithstanding this observation, the proposed imposition of the Basel III capital regime on these entities represents a seminal change in the regulation of these entities and is of significant importance in particular to SLHCs that are predominantly insurance enterprises. The Proposals are of course significant in their own right because they would impose substantial new requirements on banking organizations that have themselves been subject to Basel I capital requirements for many years. By comparison, however, the Proposals are even more significant in imposing the expanded Basel III capital regime on SLHCs that have not previously been subject to any Federal quantitative capital regime, and in imposing capital rules that are expressly designed for banking organizations on insurance enterprises and other types of SLHCs. Nowhere in the Proposals is there any acknowledgement of the fact that an entirely new capital regime is being proposed for entities that are predominantly insurance enterprises and that the new capital regime was never designed for insurance entities. Although the Board has proposed some limited adjustments to the risk-weights in the Proposals in an effort to accommodate the differences in the banking and insurance models, these accommodations fail to address the fundamental incongruity of applying bank-centric capital requirements to insurance-centric business enterprises.

As we have noted regularly and repeatedly in previous comments to the Board, BHCs and SLHCs that are predominantly engaged in insurance activities have significantly different business and risk profiles than the BHCs that the Board has traditionally regulated.[9] These BHCs and SLHCs in many instances have significantly different business models, risk profiles and capital structures than the BHCs to which the Board has applied general risk-based capital rules based on the Basel I framework. As we have specifically noted in prior comments, the Basel capital framework is a capital framework designed specifically for banks by bank regulators, and is inappropriate for application to a BHC or SLHC that is predominantly engaged in insurance activities. Neither Basel I nor Basel II nor

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speeches/chairman/spsep1412_2.html; Federal Financial Analytics, *Basel's Burst Bubble: How Basel Has Broken Apart and What Should Now Be Done to Fix Bank Regulation* (Aug. 27, 2012).

8 Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, 76 Fed. Reg. 22,662 (Apr. 22, 2011).

9 *See, e.g.*, Letter from the ACLI, to the Board (May 20, 2011), *available at* http://www.federalreserve.gov /SECRS/2011/May/20110523/OP-1416/OP-1416_052011_71615_425273793596_1.pdf; Letter from the ACLI, to the Agencies (July 28, 2011); *available at* http://www.federalreserve.gov/SECRS/ 2011/July/20110729/OP-1421/OP-1421_072811_84757_534004371354_1.pdf; Letter from the ACLI, to the Board (July 28, 2011), *available at* http://www.federalreserve.gov/SECRS/2011/August/ 20110810/R-1425/R-1425_072811_84755_533039052676_1.pdf; Letter from the ACLI, to the Board (Oct. 14, 2011), *available at* http://www.federalreserve.gov/SECRS/2011/October /20111027/ICP-201114/ICP-201114_101411_87749_380789353894_1.pdf.

Basel III is designed for a consolidated group where the top-tier entity or the predominant operating subsidiary or subsidiaries are insurance underwriting companies and the depository institution constitutes a relatively minor portion of the overall group. To subject a BHC or SLHC predominantly engaged in insurance activities to the Basel capital framework is unnecessary and disproportionate to the intended purpose of the Basel framework. Because the Basel framework was not designed for insurers, successful design of a capital framework for BHCs or SLHCs predominantly engaged in insurance activities requires that the Agencies recognize and take into account the fundamental differences between banking and insurance. Unfortunately, the Proposals fall substantially short of accounting for these fundamental differences. Instead, the Board inappropriately relies on a bank-centric approach to the treatment of insurance assets and activities, with certain limited modifications that fail to alter the Proposals' fundamentally bank-centric nature. This bank-centric approach fails to account for the fundamental differences in capital structure, risk profile, complexity and activities between insurers and banking organizations, and fails to make appropriate allowance for the significant differences between the financial profiles of traditional banking organizations and BHCs or SLHCs predominantly engaged in insurance activities.

In taking a bank-centric approach to the application of Basel III to insurers, the Board has also ignored the previous findings of its own staff concerning the differences between banking organizations and SLHCs engaged in insurance and non-financial activities. As early as 2002, Board staff recognized the difficulties associated with attempting to "fit" non-bank-centric insurers into the bank-centric model of capital regulation. As noted in a 2002 joint report of the staff of the Board and the National Association of Insurance Commissioners (the "NAIC"), the different capital approaches used by the regulators of insurance companies and banks reflect the "inherent differences between the insurance and banking industries."[10] The different capital approaches "arise from fundamental differences between the two industries, including the types of risk they manage, the tools they use to measure and manage those risks, and the general time horizons associated with exposures from their primary activities."[11] As was further noted in that report, the "two frameworks differ fundamentally in the risks they are designed to assess, as well as in their treatments of certain risks that might appear to be common to both sectors" and "*the effective capital charges cannot be harmonized simply by changing the nominal capital charges on an individual basis*."[12] The lack of appropriate accommodation of insurance enterprises affected by the Proposals is hard to understand given the findings of the aforementioned study.

When the Board began the process of implementing its new supervisory authority over SLHCs given to it by the Dodd-Frank Act, it noted in its April 2011 Notice of Intent that it was considering applying to SLHCs capital and leverage requirements applicable to BHCs "*to the extent reasonable and feasible* taking into consideration the unique characteristics of SLHCs and the requirements of HOLA."[13] At the same time, the Board recognized that "SLHCs have traditionally been permitted to

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10 Report of the NAIC and the Federal Reserve System Joint Subgroup on Risk-based Capital and Regulatory Arbitrage (May 24, 2002), at 1.

11 *Id*. at 3.

12 *Id.* (emphasis added).

13 Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, 76 Fed. Reg. at 22,665 (emphasis added).

engage in a broad range of nonbanking activities that were not contemplated when the general leverage and risk-based capital requirements for BHCs were developed."[14]

Presumably cognizant of the findings of the 2002 joint report with the NAIC, the Board in its April 2011 Notice of Intent specifically asked for comments on the unique characteristics, risks and specific activities of SLHCs that the Board should take into account when developing consolidated capital requirements for SLHCs as well as appropriate transition periods for applying any such ultimate capital requirements to SLHCs.[15] The Board received extensive comments, particularly from SLHCs that are predominantly insurance enterprises, in response to the April 2011 Notice of Intent.[16] Similarly, when the Board issued a rule implementing certain aspects of the Collins Amendment, it received "substantial comments" from insurance companies including comments that the risk profiles, balance sheet characteristics, and business models differ fundamentally between banks and insurance companies.[17] The proposals do not seriously address these detailed comments.

The Proposals do not reflect any serious consideration of the fundamental issues presented by the imposition of bank-centric capital requirements on SLHCs that are predominantly insurance enterprises. Indeed, the Proposals suggest that the Board has failed to engage in any meaningful or substantive cost-benefit analysis concerning the imposition of bank-centric capital requirements on insurance enterprises. Such an analysis would demonstrate the inappropriateness of the proposed approach, its lack of connection to the risks posed by insurers, its unjustified punitive impact on insurers' businesses, and the distortive view of insurers' actual economic soundness it can produce. The Proposals simply propose to adjust the nominal risk-weights for a few types of assets: policy loans, separate accounts, and deferred acquisition costs and value of business acquired. This nominal approach is precisely what the staff of the Board concluded in the 2002 study would *not* effectively address the fundamental differences between a bank-centric capital approach and an insurance-centric capital approach. Nowhere do the Proposals explain or justify the Board's change of position.

In addition, the Proposals make no effort to address the special transition period problems for SLHCs that have not previously been required to develop the accounting and other information systems to support the capital requirements reflected in the Proposals. This problem exists for many SLHCs, but it is nowhere more evident than in the case of mutual insurance companies and fraternal benefit societies that only prepare financial statements according to Statutory Accounting Principles ("SAP"). While the preamble to the Standardized Approach NPR recognizes that the Board had received many comments on this fundamental problem, the preamble and the Standardized Approach NPR make no reference to any solution to this problem and thus apparently assume that these insurance companies will be preparing capital calculations commencing in the first quarter of 2013 based on consolidated financial statements.[18] This is an inherently unrealistic assumption. We submit that

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14 *Id*.

15 *Id*.

16 *See* Paul L. Lee, *Savings and Loan Holding Companies After the Dodd-Frank Act: An Endangered Species? Part II*, 129 Banking L. J. 195, 198-203 (2012).

17 Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor, 76 Fed. Reg. 37,620, 37,624 (June 28, 2011).

18 For example, the Standardized Approach NPR would require banking organizations predominantly engaged in insurance activities with $50 billion or more in total consolidated assets to provide a variety of

the Proposals are fundamentally deficient in their failure to address the well-documented issues presented by SLHCs that are predominantly insurance enterprises.

We are deeply concerned that if implemented as proposed, the Proposals will disrupt the traditional business of insurance and the risk management frameworks that insurers have in place to manage the risks that arise from their traditional business. One example of this relates to the proposed removal of the existing accumulated other comprehensive income (AOCI) filter, discussed in detail later in this commentary.

We do not believe the Agencies intend to disrupt the insurance business, or that they intend to incent insurance companies to reduce their participation in or exiting the very markets for which their balance sheets are designed (*i.e.*, markets involving long-dated risks). We do not believe that decreasing or eliminating their participation in these markets serves a useful social, economic or regulatory purpose or enhances the safety and soundness of the financial system. We believe that these and other negative results can be avoided if the Agencies simply recognize and make appropriate accommodation for the fact that in certain important respects, the insurer balance sheet is fundamentally different from the bank balance sheet, and as such an almost wholesale application of the Basel III framework to BHCs or SLHCs that are predominantly insurance enterprises is misguided and contrary to the very purposes of the Dodd-Frank Act.

We therefore respectively request that the Board conduct a quantitative impact study of the proposed capital standards with respect to the insurance industry prior to any further action regarding this rulemaking and insurance enterprises. The Board has already performed this type of detailed review repeatedly over time in order to aid in its analysis of the design and consequences of the Basel capital standards on banks. The same data-driven analysis should occur with regard to the insurance industry and the results should inform decision-making. The results of a quantitative impact study as described should help guide further rulemaking to ensure that appropriate capital standards are applied for insurance companies versus relying on modified banking standards that, as has been discussed repeatedly, simply cannot address the risks posed by insurance entities.

2. Impact of the Collins Amendment

The Proposals would generally apply to SLHCs to the same extent and under the same timeline as to U.S. banks, savings associations and BHCs (with the exception of small BHCs with consolidated assets of less than $500 million). However, the Proposals would not apply the same implementation timeline to U.S. subsidiaries of foreign banking organizations that rely on the Board's Supervision and Regulation Letter 01-1 ("SR 01-1 Holding Companies"). SR 01-1 Holding Companies would not be required to comply with the proposed capital requirements under any of the Proposals until July 21, 2015. In providing that the Proposals will not apply to SR 01-1 Holding Companies until July 21, 2015, the Board specifically cites subsection 171(b)(4)(E) of the Dodd-Frank Act.

In providing that the Proposals apply to SLHCs to the same extent and according to the same timeline as other classes of depository institutions and their holding companies, but do not apply to SR 01-1 Holding Companies until July 21, 2015, the Agencies have taken an arbitrary and capricious position that contradicts the plain language of the Collins Amendment and is clearly inconsistent with Congressional intent. Section 171(b)(4)(E) of the Dodd-Frank Act, which provides that SR 01-1 Holding Companies are not subject to the Collins Amendment until July 21, 2015, reads as follows:

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disclosures explicitly based on GAAP. *See, e.g.*, Standardized Approach NPR, 77 Fed. Reg. at 52,970 (general disclosures related to credit risk).

"(E) CERTAIN BANK HOLDING COMPANY SUBSIDIARIES OF FOREIGN BANKING ORGANIZATIONS. – For bank holding company subsidiaries of foreign banking organizations that have relied on Supervision and Regulation Letter SR-01-1 issued by the Board of Governors (as in effect on May 19, 2010), the requirements of this section, **except as set forth in subparagraph (A), shall be effective 5 years after the date of enactment of this Act.**"

Section 171(b)(4)(D), which provides that SLHCs are not subject to the Collins Amendment until July 21, 2015, reads as follows:

"(D) DEPOSITORY INSTITUTION HOLDING COMPANIES NOT PREVIOUSLY SUPERVISED BY THE BOARD OF GOVERNORS. – For any depository institution holding company that was not supervised by the Board of Governors as of May 19, 2010, the requirements of this section, **except as set forth in subparagraphs (A) and (B), shall be effective 5 years after the date of enactment of this Act.**"

The near symmetry of the above provisions reflects a clear and unambiguous expression of Congressional intent that neither SLHCs nor SR 01-1 Holding Companies should be subject to consolidated capital requirements until July 21, 2015. Nevertheless, the Agencies have chosen to require SLHCs to comply with new minimum capital ratios by calendar year 2013, with little regard for the consequences to affected SLHCs that heretofore assumed that the Board would respect the plain language of the Collins Amendment and would in any event provide a reasonable transition period for any new capital regime.

We strongly oppose this clear contravention of Congressional intent, and strongly urge the Agencies to reconsider the arbitrary treatment of SLHCs reflected in this approach. Section 171(b)(4)(D) stands for a Congressional recognition that because SLHCs have never before been subject to consolidated capital requirements, they require an extended period of time to bring themselves into compliance with the generally applicable minimum capital requirements contemplated by the Collins Amendment. The analysis is precisely the same with respect to section 171(b)(4)(E), as SR 01-1 Holding Companies are not subject to consolidated capital requirements in the U.S., and therefore require a similar extended transition period. Since SLHCs and SR 01-1 Holding Companies are similarly situated, it is unsurprising that the language of sections 171(b)(4)(D) and (E) are almost precisely the same. Given Congress's clear intent to provide for similar transition periods for both classes of institutions, it is disconcerting that the Agencies have arbitrarily chosen to afford one class the benefit of the plain language of the Collins Amendment, but not the other. While we recognize that section 616(b) of the Dodd-Frank Act provides the Board with general authority to promulgate capital rules for SLHCs, as discussed above the general grant of authority in section 616(b) in no way supersedes the more specific and explicit direction in section 171(b)(4)(D) with respect to the appropriate transition period for capital rules for SLHCs.[19,20]

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19 In proposing that SLHCs be subject to the Proposals under the same timeline as other banking organizations, we presume that the Board is relying on its general authority to promulgate regulations relating to capital requirements for SLHCs under section 10(g)(1) of HOLA, which was added by section 616(b) of the Dodd-Frank Act. We urge the Board to construe this amendment to the general provisions of HOLA in section 616(b) together with the specific timing requirements laid out in section 171(b)(4)(D). Such a reading is consistent with basic canons of statutory construction: a statute should read as a whole, and not selectively (*Brotherhood of Locomotive Engineers v. Atchison, T.&S.F.R.R.,* 516 U.S. 152, 157 (1996)); every word in a statute should be given effect (Congress is presumed to know how to write laws, *Astoria Federal Savings & Loan Ass'n. v. Solimino,* 501 U.S. 104, 112 (1991)); and specific terms in a statute override general terms (*Fourco Glass v. Transmirra Products Corp.,* 353 U.S. 222, 228 (1957)).

Finally, we must emphasize that the application of the requirements of the Collins Amendment as envisioned by the Proposals to SLHCs even on the deferred basis required by section 171(b)(4)(D) nonetheless presents serious issues under the McCarran-Ferguson Act for SLHCs that are predominantly engaged in the business of insurance. As noted earlier, Section 171(b) requires the Federal banking agencies to establish minimum leverage and risk-based capital requirements on a consolidated basis for BHCs, SLHCs and nonbank financial companies that may not be less than the generally applicable leverage and risk-based capital requirements in effect for insured depository institutions as of the date of enactment of the Dodd-Frank Act. Regulatory implementation of these requirements by applying bank-centric capital requirements to SLHCs that are predominantly engaged in the business of insurance raises significant issues under the McCarran-Ferguson Act.

First, it is clear that the Section 171 is not an act that "specifically relates to the business of insurance" within the meaning of the McCarran-Ferguson Act. There is no reference either direct or indirect in Section 171 to the business of insurance or any aspect of the business of insurance. Second, as discussed in Part I of this letter and in further detail in the other sections of Part II of this letter, the application of bank-centric capital rules to SLHCs that are predominantly engaged in the business of insurance, and that completely disregard the State-based regulatory capital and reserving regimes, would, in contravention of the McCarran-Ferguson Act, impair the laws enacted by the States for the purpose of regulating the business of insurance by adversely affecting *inter alia* the risk management practices and many other aspects of the insurance business that are already governed under State insurance law requirements. We submit that in the absence of the approach recommended in Part I of this letter to Section 171, the application of Section 171 on July 21, 2015 to SLHCs that are predominantly engaged in the business of insurance will contravene the provisions of the McCarran-Ferguson Act.

3. Transition Period and Compliance with New Minimum Capital Ratios

The Proposals appear to require that all SLHCs must maintain the following minimum risk-based capital ratios by calendar year 2013: a (i) common equity tier 1 ("CET1") capital ratio of 3.5 percent; (ii) Tier 1 capital ratio of 4.5 percent; and (iii) total capital ratio of 8.0 percent. In addition, the Proposals impose a leverage ratio of Tier 1 capital to average total consolidated assets of 4.0 percent. In requiring that all SLHCs meet these minimum ratios by calendar year 2013, the Proposals do not provide for any meaningful transition period for SLHCs to bring themselves into compliance with the new minimum capital requirements that are being imposed on SLHCs for the very first time.

In addition to the significant problems associated with the bank-centric nature of the Proposals and their application to insurance enterprises, the Agencies have arbitrarily and capriciously chosen not to provide SLHCs with any transition period for compliance with the new minimum capital ratios. As discussed above, the Agencies seem to have ignored the clear Congressional intent expressed in section 171(b)(4)(D), which provides that SLHCs should not be subject to consolidated minimum capital requirements until July 21, 2015. In addition, the Agencies have failed to provide for a meaningful transition period for SLHCs predominantly engaged in insurance activities. Such a transition period is clearly within the ambit of the Board's regulatory and supervisory authority, and yet, the Board seemingly contemplates that an insurance group that has heretofore not been subject to bank-centric capital rules and Federal consolidated capital requirements and for which the

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20 In addition, and as discussed earlier, we believe the language of section 171 allows the Board to make a regulatory interpretation of the statute that would allow the Board to make a determination that the life insurer RBC requirements will not result in "less than" nor "quantitatively lower than" the bank risk based and leverage capital requirements referenced in that section.

affiliated savings association often constitutes a relatively small percentage of the group's total assets will be able to re-engineer its operations, its compliance systems, its accounting management information systems ("MIS systems") and its basic capital structure within a matter of months to comport with bank-centric capital requirements.

The need for a meaningful transition period is particularly acute in the case of SLHCs predominantly engaged in insurance activities. In addition to never before being subject to bank-centric capital rules and Federal consolidated capital requirements, as is the case with all SLHCs, insurance-centric SLHCs do not engage in a substantial amount of traditional banking activities, and therefore have not designed their MIS systems and other compliance systems to collect and aggregate the types of information necessary to calculate and report regulatory capital ratios on a consolidated basis. As the Board is aware, a number of these institutions do not even prepare U.S. GAAP consolidated financial statements and instead prepare their financial statements under SAP.[21],[22] Failing to account for the special concerns presented by SLHCs currently preparing only SAP financial statements, the Basel III NPR appears to require exempt SLHCs to follow the instructions to the FR Y-9C report for purposes of the Basel III NPR capital calculations – even though such exempted SLHCs are not currently filing FR Y-9C quarterly reports.[23] The instructions to the FR Y-9C report expressly state that the financial statements be prepared on a consolidated basis in accordance with generally accepted accounting principles. An exempted SLHC will simply not be in a position to comply with these requirements on the timetable reflected in the Basel III NPR.

A January 2013 effective date is particularly unreasonable for insurance-centric SLHCs that are mutual insurance companies or fraternal benefit societies. In the event a mutual insurance company or fraternal benefit society would need to improve its common equity tier 1 risk-based capital ratio by 2013, it could only do so through the retention of earnings or a reduction of risk-weighted assets as these companies do not have access to the capital markets. Due to the short-time frame for compliance, a reduction of risk-weighted assets is likely the only viable option, which could result in an insurance company divesting assets or rebalancing its investment portfolio in a manner that is imprudent for risk management purposes. We do not believe that such a re-balancing in such a short period of time would be helpful, either for the insurers that would be forced to engage in such re-balancing, for the economy or for the financial system as a whole.

We respectfully submit that it was a significant error for the Board not to have provided an extended transition period for SLHCs predominantly engaged in insurance activities to bring themselves into compliance with the proposed required minimum capital ratios. Consistent with the clear Congressional intent expressed in section 171(b)(4)(D), this transition period should at a minimum provide that SLHCs, whether or not predominantly engaged in insurance activities, will not be subject

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21 In recognition of this fact, the Board provided a temporary exemption from its SLHC information reporting requirements adopted in December 2011 for a SLHC that does not submit reports to the Securities and Exchange Commission pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934. Specifically, an exempted SLHC is not required to file the quarterly FR Y-9C financial statement report. Moreover, SLHCs that are required to file the FR Y-9C reports are not currently required to complete Schedule HC-R: Regulatory Capital. *See* Agency Information Collection Activities Regarding Savings and Loan Holding Companies: Announcement of Board Approval Under Delegated Authority and Submission to OMB, 76 Fed. Reg. 81,933, 81,934-936 (Dec. 29, 2011).

22 In addition, some internationally-based insurers report on an IFRS basis and do not have U.S. GAAP-based financial statements readily accessible.

23 *See, e.g.*, Standardized Approach NPR, 77 Fed. Reg. at 52,878 (stating that SLHCs "that do not file the FR Y-9C should follow the instructions to the FR Y-9C.").

to minimum capital requirements under the Proposals until July 21, 2015. In addition, the Board should consider an additional transition period for SLHCs that are predominantly engaged in insurance activities, a transition period that takes into account the fundamental differences between insurance and banking operations and capital requirements associated with these operations. There is clear precedent for such an extended transition period. For instance, when the Basel I risk-based capital rules were originally adopted in the U.S., the Agencies provided for a three-year delay in implementation so that banking organizations had sufficient time to bring themselves into compliance with the new framework.

This is another illustration of our earlier point that the proposed capital rules are the wrong standards for BHCs and SLHCs that are predominately engaged in insurance activities. We respectfully urge the Board to reconsider its position and propose capital standards that are appropriate for these enterprises.

4. Specific Comments

Below, we provide specific comments on the Proposals. First, we provide comments on issues relating to the proposed treatment of assets and activities specific to insurance companies. Second, we provide comments on general issues presented by the Proposals that are important to insurance companies. Our comments should not be construed as acknowledging the appropriateness of applying bank-centric capital standards to insurance enterprises. Instead, our comments are meant to highlight the inadequacy of such an approach and to highlight examples of capital standards for insurance-centric BHCs and SLHCs that must be tailored to avoid damaging their insurance businesses. We do not maintain there cannot be capital standards for those firms; we merely maintain that the standards should be the right standards, and that the standards proposed by the Agencies are not the right standards.

B. Treatment of Insurance Assets and Activities

1. Regulatory Capital Deduction for Insurance Underwriting Subsidiaries

The Proposals would require that a BHC or SLHC with an insurance underwriting subsidiary deduct from its consolidated capital ratios an amount equal to the minimum regulatory capital requirement established by the regulator of any insurance underwriting subsidiary of the holding company. For U.S.-based insurance underwriting subsidiaries, this amount generally would be 200 percent of the subsidiary's authorized control level risk-based capital, as established by the appropriate state regulator of the insurance company.

In the preamble to the Standardized Approach Proposal, the Board states that requiring the deduction of capital held by a BHC's or SLHC's insurance underwriting subsidiaries is consistent with the approach taken in the context of the Board's adoption of the advanced approaches rules in 2007. In the preamble to the 2007 final rule implementing the advanced approaches, the Board stated, in response to comments objecting to the required deduction of capital held by insurance underwriting subsidiaries, that it

"[does] not agree that the proposed approach results in a double-count of capital requirements. Rather, the capital requirements imposed by a functional regulator or other supervisory authority at

the subsidiary level reflect the capital needs at a particular subsidiary. The consolidated measure of minimum capital requirements should reflect the consolidated organization."[24]

It would not be sound policy for the Board to require the deduction of capital held by insurance underwriting subsidiaries of BHCs or SLHCs that are predominantly insurance enterprises simply because it is consistent with the approach taken in the 2007 advanced approaches rule. The advanced approaches rules by their terms apply only to the largest banking organizations, and none of the institutions that implemented the advanced approaches pursuant to the 2007 rule have substantial insurance underwriting subsidiaries in relation to their banking subsidiaries. Advanced approaches institutions predominantly engage in banking activities, do not have significant insurance subsidiaries and were not significantly impacted by the required deduction.[25] Yet the Board proposes to import a principle from the advanced approaches rules that would apply to a BHC or SLHC predominantly engaged in insurance activities, regardless of its size and regardless of the extent to which insurance activities predominate within the consolidated enterprise.[26]

As an analytical matter, the Board's approach in the advanced approaches rule reflects a misunderstanding of the insurance risk-based capital framework. Among other risks, the insurance risk-based capital framework specifically accounts for asset-specific risks that are also included in the risk-based capital rules for banking organizations. The risk-based capital framework for life insurers measures five specific categories of risk:

- C0 – Asset Risk – Affiliates;
- C1 – Asset Risk – Other;
- C2 – Insurance Risk;
- C3 – Interest Rate Risk; Health Credit Risk; and Market Risk; and
- C4 – Business Risk.

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[24] Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II, 72 Fed. Reg. 69,288, 69,325 (Dec. 7, 2007). In adopting this posture, the Board also indicated that a fully consolidated approach with a deduction from consolidated capital for the minimum capital requirement imposed by the functional regulator of the insurance subsidiaries would eliminate the potential for regulatory capital arbitrage: "it eliminates incentives to book individual exposures at a subsidiary that is deducted from the consolidated entity for capital purposes where a different, potentially more favorable, capital treatment is applied at the subsidiary." *Id.* We submit that the booking of admitted assets on the balance sheet of an insurance enterprise in accordance with the standard insurance asset and liability model can scarcely be characterized as arbitrage.

[25] Although our main commentary primarily discusses the impact of the proposed regulatory capital deduction on entities that are predominantly insurance enterprises, we firmly believe an insurance subsidiary of any BHC, SLHC or other financial institution affected by the Proposals should be treated in the same manner for deduction of capital purposes.

[26] Indeed, in adopting the advanced approaches rule in 2007, the Board excluded assets held by insurance underwriting companies from the calculation of total consolidated assets for purposes of the $250 billion threshold. The Board explained that it excluded assets held in insurance underwriting subsidiaries from the $250 billion threshold of consolidated assets "because the advanced approaches were not designed to address insurance underwriting exposures." *Id.* at 69,298.

For property and casualty insurers, the risk-based capital framework measures six specific categories of risk:

- R0 – Asset Risk – Affiliates;
- R1 – Asset Risk – Fixed Income Investments;
- R2 – Asset Risk – Equity Investments;
- R3 – Asset Risk – Credit;
- R4 – Underwriting Risk – Reserves; and
- R5 – Underwriting Risk – Net Written Premium.

For life insurers, asset-related risks are encompassed in the C1 and C3 categories, which measure risks arising from the asset side of the balance sheets of the insurance company and its affiliates, as well as interest rate and market risks highly correlated with the asset composition and quality of the insurer's balance sheet. For property and casualty insurers, asset-related risks are encompassed in the R1, R2 and R3 categories, which also measure risks arising from the asset side of the property and casualty insurer and its affiliates. The C0 and R0 categories include the total RBC of insurance subsidiaries and therefore are a combination of both insurance risk and asset risk. In light of these similarities, it would be unreasonably punitive to require a BHC or SLHC predominantly engaged in insurance activities to deduct capital held by its insurance underwriting subsidiary to cover these risks when the capital measures the same types of risks as the general risk-based capital rules.

To the extent the Board deems it necessary for a BHC or SLHC to deduct any capital held by its insurance underwriting subsidiaries, these deductions should only encompass the categories of insurance risk-based capital that do not measure asset-specific risks, such as the C2 and C4 categories for life insurers, and the R4 and R5 categories for property and casualty insurers. It simply makes no rational sense for the Board to require a consolidated enterprise to deduct capital held by a subsidiary to the extent that the capital framework applicable to the subsidiary measures comparable risks as the framework applicable on a consolidated basis. Moreover, the Proposals do not require a similar deduction for other wholly-owned subsidiaries that are subject to capital requirements by another functional regulator, such as insured depository institutions or broker-dealers. It would be highly discriminatory to penalize a particular class of wholly-owned subsidiaries from a capital perspective, particularly when equivalent deductions are not required for other classes of wholly-owned subsidiaries that also maintain capital to address risks at the subsidiary level. The contemplated deduction of capital held by insurance underwriting subsidiaries arbitrarily and capriciously penalizes the business of insurance, and does so by penalizing a capital framework that measures risk in a manner generally similar to the general risk-based capital rules. For more information, please see Appendix BB, which explains how the contemplated deduction inequitably requires a BHC or SLHC that is predominantly an insurance enterprise to hold more capital for the same amount of asset risk as a BHC or SLHC without an insurance company subsidiary.

To require BHCs and SLHCs predominantly engaged in insurance activities to deduct a designated amount of capital held by their insurance underwriting subsidiaries would cause significant harm to these institutions. For insurance-centric BHCs or SLHCs, insurance underwriting subsidiaries constitute the predominant part of the consolidated entity's assets and the predominant part of the consolidated capital. As such, to require the deduction of a significant part of the capital of a predominant subsidiary without a corresponding deduction from the denominator of the capital ratios of a *pro rata* amount of assets would for all intents and purposes eviscerate the consolidated regulatory capital of these institutions. Similar to the proposed removal of the AOCI filter, which we discuss below, the proposed deduction of capital held by insurance underwriting subsidiaries would negatively impact insurers' ability to offer long-term retirement products like annuities to consumers, as the proposed deduction would essentially impose severe capital penalties on insurers for offering these products.

This illustrates our point that the proposed rules are not appropriate capital standards for BHCs and SLHCs that are predominantly engaged in insurance activities. We strongly recommend that the Board adopt capital standards that do not require a BHC or SLHC to deduct capital held by its insurance underwriting subsidiaries. This is an issue that should be addressed in a rulemaking for capital standards that are tailored to these enterprises.

2. <u>Separate Accounts</u>

Many life insurers maintain significant separate account balances reflected as assets and offsetting liabilities on their balance sheets. The insurance company records the assets supporting the separate account liabilities on its balance sheet along with an offsetting policyholder liability equal to the fair value of those assets. The insurance company is also required under state law to hold other liabilities to reflect obligations for policyholder benefits related to the separate account products. The term "separate account" reflects that the assets are set aside apart from the general account assets and are not subject to the claims of the general creditors of the insurance company or the creditors of an affiliate of the insurance company.

The Proposals provide that the risk weight assigned to separate accounts would depend on whether the separate account is a guaranteed or non-guaranteed separate account. The Proposals define a separate account generally as a legally segregated pool of assets owned and held by an insurance company and maintained separately from the insurance company's general account assets for the benefit of an individual contract holder that meets the following conditions: (i) the account is legally recognized under applicable law; (ii) assets in the account are insulated from the general liabilities of the insurance company in the event of the company's insolvency; (iii) the insurance company invests the funds within the account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies; and (iv) all investment gains and losses, net of contract fees and assessments, are passed to the contract holder, provided that the contract may specify conditions under which there may be a minimum guarantee but must not include terms that limit the maximum investment returns available to the policyholder. The Proposals define a non-guaranteed separate account as a separate account where the insurance company (i) does not contractually guarantee either a minimum return or account value to the contract holder and (ii) is not required to hold reserves (in the general account) pursuant to its contractual obligations to a policyholder. Under the Proposals, any separate account that meets the definition of a non-guaranteed separate account will be assigned a zero percent risk weight, while any separate account that does not meet the definition of a non-guaranteed separate account will be assigned to a risk weight category based on the risk weight of the underlying assets.

This letter makes three points relating to the Proposals' treatment of separate accounts: first, the definition of "non-guaranteed separate account" is wrong as it is inconsistent with state insurance law; second, the capital charges for separate accounts that do not satisfy the criteria for "non-guaranteed separate account" are based on a misunderstanding of the nature of the risk to the insurance company; and third, separate account assets should not be included in the denominator for the calculation of the Tier 1 leverage ratio.

The definition of "non-guaranteed separate account" is simply wrong. The second prong of the definition, which says "...a separate account where the insurance company ... is not required to hold reserves (in the general account) pursuant to its contractual obligations to a policyholder" is far too broad. Insurance companies hold general account reserves for contractual commitments they make in their variable life and variable annuity products (that is, contracts that include separate accounts). These reserves are required by state insurance laws and are computed in accordance with well-established actuarial regulations, guidelines and standards. Pursuant to state law, the reserves are backed by general account assets.

For variable insurance products, the contractual commitments are not guarantees of the value of separate account assets; they are promises by the insurance company to pay an additional benefit in the event of an insurable event (e.g. death or extended longevity). Minimum guaranteed death benefits in life insurance policies and guaranteed living benefits in annuities are examples of those kinds of contractual commitments. The risks associated with those commitments are, again, reflected in the insurers' general account reserve obligations, as state insurance law requires, and they are backed by general account assets that are in turn subject to a capital charge (via risk weighting). Neither the contractual obligation nor the general account reserves are guarantees of separate account asset performance or values. Thus, there is no reason to assess a second capital charge against the separate account assets, and doing so in light of the existing capital framework is double counting and punitive.

The broad scope of the proposed definition of "non-guaranteed separate account" to include all insurance company general account reserves for all contractual obligations demonstrates a misunderstanding of the insurance capital regime, and it unreasonably punishes insurance companies that offer variable products. This is yet another example of the fundamentally poor fit of the proposed capital rules to the insurance business. We respectfully urge the Board to start over to adopt capital standards that are appropriate for enterprises that are predominantly engaged in insurance activities.

Likewise, applying a capital charge to separate accounts assets that are in separate accounts that do not meet the criteria for "non-guaranteed separate accounts" does not appropriately reflect their risk. We recognize that such separate accounts present risk to an insurer and it is appropriate for an insurer to hold capital against those risks. However, the risk to the insurer is derived from the value of the <u>guarantee</u> related to those separate accounts assets as opposed to the value of the underlying assets. Thus, any capital charge under any capital framework should be applied to the value of the guarantee, not to the value of the underlying assets. The RBC framework specifically accounts for the risks posed by these kinds of separate accounts through the C3 (Interest Rate and Market Risk) capital charge. Risk weighting the underlying assets in those separate accounts would have the counter intuitive effect of requiring higher capital when the risk posed by the guarantee is lower. To illustrate, as the value of the assets in those separate accounts increases, the potential risk of the guarantee being realized is reduced as the guarantee is "further out of the money"; however, under the Proposals, the risk weighting would inappropriately be applied to the market value of the assets, which would result in higher capital charges despite the decline in the value and risk of the guarantee. The amount of the potential risk from these guarantees is determined through a defined stochastic analysis, which results in an appropriately applied C3 charge under the RBC framework. We believe this highlights a further example of how the proposed rules inappropriately reflect the business of insurance.

We are also concerned that the Proposals do not appear to exclude separate accounts from the denominator of the Tier 1 leverage ratio. The Basel III NPR provides that the denominator of a banking organization's Tier 1 leverage ratio would be composed of the banking organization's total consolidated assets as reported on the organization's regulatory report, minus amounts deducted from Tier 1 capital. The proposed definition of the Tier 1 leverage ratio would therefore appear to require a BHC or SLHC to include separate account assets in its Tier 1 leverage ratio denominator to the extent the separate account assets are reported as on-balance sheet items in the applicable regulatory report. Separate account assets are not subject to the claims of the general creditors of an insurance company or any of the company's affiliates. Debtholders cannot force an insurer to liquidate separate account assets. In addition, any liquidation of separate account assets would be met by selling them in the open market, and an insurer would have no debt or leverage liabilities associated with those assets. Given these facts, the Board should exclude these assets from the Tier 1 leverage ratio calculation. This proposed exclusion is consistent with the principal objective of the Tier 1 leverage ratio, which is to constrain a banking organization's ability to leverage its equity capital base. The ratio is intended to limit risk, and can be used as a supplement to the general risk-based capital ratios. The FSOC specifically excluded separate accounts from the leverage ratio calculation in its recent final rule and interpretive guidance, stating that such an exclusion was appropriate because separate accounts are "not available to claims by general creditors of a nonbank financial company."[27]

We are deeply concerned that if the Agencies proceed to force insurers to hold substantial capital against their separate account assets, the result will be significant competitive inequality between insurers and banking organizations. Banking organizations will be permitted to offer products and services which compete with separate accounts without being subject to capital requirements, while insurers will be unable to offer competitive separate account products without being subject to capital requirements. The result of this competitive inequality will be the movement of customer assets from insurers to banking organizations, and a negative impact on the ability of insurers to offer annuities and other retirement products involving separate accounts. We urge the Agencies to take appropriate account of the structure and state law requirements of separate account assets held by insurers and adopt rules that avoid negatively affecting the availability of competitively priced protection products uniquely offered by insurance companies.

3. Surplus Notes

The Proposals provide that surplus notes issued by an insurance company would be ineligible for treatment as Tier 1 capital, but would be eligible for treatment as Tier 2 capital if the notes met the proposed criteria for Tier 2 eligibility. According to the Board, permitting surplus notes to qualify as Tier 1 capital would be "inconsistent with the proposed eligibility criteria for regulatory capital instruments . . . because surplus notes generally do not reflect the required loss absorbency characteristics of Tier 1 instruments under the proposal." We believe that surplus notes issued by insurance companies will generally meet the criteria specified in the Basel III NPR for Tier 2 capital instruments, subject to certain clarifications. For example, one of the criteria for Tier 2 capital instruments is that any option to call such an instrument must be subject to the prior approval of the applicable Federal banking agency. Surplus notes issued by insurance companies by their terms require approval from the applicable insurance regulator for any payment or prepayment of principal or interest. We assume that this requirement for approval by the applicable insurance regulator would be deemed to satisfy the criterion in the Tier 2 capital instrument for prior approval by a Federal banking agency. This is a further illustration of the failure of the proposed rules to address insurer-centric BHCs and SLHCs and of the need to tailor capital rules to the business and risk characteristics of those firms. We respectfully urge the Board to clarify this issue when such rules are developed.

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27 Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,661 (Apr. 11, 2012).

4. Policy Loans

The Proposals would define policy loans as loans by an insurance company to a policyholder pursuant to the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract. A policy loan would include (i) a cash loan, including a loan resulting from early payment benefits or accelerated payment benefits, on an insurance contract when the terms of the contract specify that the payment is a policy loan secured by the policy, and (ii) an automatic premium loan, *i.e.* a loan made in accordance with policy provisions which provide that delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments. The Standardized Approach NPR would assign a 20 percent risk weight to policy loans. According to the Board, assigning a 20 percent risk weight to policy loans is similar to the treatment of a cash secured loan, and such treatment is appropriate in light of the fact that should a borrower default, the resulting loss to the insurance company would be fully offset by the right to access the cash surrender value or collateral assignment of the related policy. In fact, a cash secured loan would be assigned a zero percent risk weight under the Standardized Approach NPR and a policy loan should likewise be assigned a zero percent risk weight.

We believe that assigning a 20 percent risk weight to policy loans would be inappropriate in light of the fact that the insurance company, when its insurance policy provides for policy loans, generally retains rights of setoff against the related policy benefits. Pursuant to these setoff rights, the insurance company can immediately net the relevant portion of the insurance policy loan principal and interest payments against the policy death benefit or cash surrender value in the event of a policyholder policy loan default, and thus immediately mitigate any loss that might otherwise arise. No issue relating to collateral, or the adequacy or availability of collateral, can arise regarding policy loans. Given these setoff rights built into the insurance policy terms and conditions, we believe that policy loans should be assigned a zero percent risk weight. We respectfully submit that this apparent misunderstanding of the character of policy loans for risk weighting purposes is another example of the need for the Board to rethink the capital model for SLHCs that are primarily engaged in insurance, and adopt standards calibrated to the business model and risks of those types of businesses.

C. Other Issues

1. Gains and Losses on Available for Sale Securities

The Proposals would require that (i) all unrealized losses on available for sale ("AFS") equity securities immediately "flow through" to a covered banking organization's CET1 capital and (ii) unrealized gains on AFS equity securities and unrealized gains and losses on AFS debt securities flow through to CET1, subject to a five-year phase-in.

We are deeply concerned that the removal of the existing AOCI filter will have a disproportionately negative impact on life insurers. Because of their long-dated liabilities and the need to invest in assets to match these long-dated liabilities, life insurers often hold significantly larger portfolios of longer-term AFS debt securities than traditional banking organizations and hold them for long periods of time.[28] Fluctuations in interest rates on these long-term debt securities will therefore

[28] According to the Federal Reserve Flow of Funds, at year end 2010, commercial banks held 22% of total financial assets in bonds (treasury securities, agency-backed, municipal, corporate & foreign bonds), whereas life insurers held 52% of assets in bonds. Although It is not possible to determine the exact duration of the bonds held by banks, it is known that insurers typically purchase bonds with a maturity of 10 or more years (62% of bond purchases). The Flow of Funds also notes that in 2010 77% of life insurer

have a disproportionate impact on insurers' regulatory capital ratios, an impact that will only be fully understood as the overall economy transitions away from the current low interest rate environment. The Agencies themselves indicate that they "recognize that including unrealized gains and losses related to certain debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate *could introduce substantial volatility in a banking organization's regulatory capital ratios*."[29] We agree, and state unequivocally that increased volatility of regulatory capital ratios will impact life insurers to a much greater extent than banking organizations, due to their proportionately greater holdings of AFS debt securities and the significantly longer maturities of most debt securities held by insurance companies.

The significantly increased volatility in life insurers' regulatory capital ratios will present significant challenges. First and foremost, increased volatility will cause significant fluctuations in insurers' regulatory capital ratios. These fluctuations will be significantly greater in magnitude than those experienced by traditional banking organizations, and may cause the unintended result of having the insurers' capital ratios appear lower than warranted by the overall safety and soundness of the organization. By way of example, one insurer indicates that a 100 basis point movement in interest rates would cause its consolidated regulatory capital ratios to fluctuate by approximately two percentage points (*e.g.*, reducing regulatory capital from 10 percent to 8 percent). Assuming that the Proposals were in effect during the financial crisis, some insurers would even have reported regulatory capital ratios below the regulatory minimum, despite the market recognition that the life insurance industry weathered the financial crisis on a better basis than many banking organizations. These examples illustrate the fundamental problems arising from any attempt to require an insurer to include gains and losses on AFS debt securities in its regulatory capital ratios. Moreover, because the Basel framework focuses entirely on assets (rather than liabilities), the Proposals take almost no account of the fundamental importance of matching longer-term assets to the liability side of the insurer balance sheet. To ignore the fundamental importance of this concept is to ignore one of the most important constructs in the entire insurance risk management framework.

Insurance companies would have to respond either by increasing their capital to absorb the increased capital volatility that removal of the AOCI filter would cause, or by decreasing their holding of long-term securities. The latter outcome would require the companies either to take interest rate risk – to increase asset-liability maturity mismatches – with a resulting increase in overall risk for the company, or to reduce their participation in, or even exit, markets involving long-dated risks.

Given insurance companies' balance sheets and their large investments in long-term assets to match their long-term liabilities, and the demonstrated durability of those balance sheets under stress, we see no discernible safety and soundness benefit to insurance companies of increasing capital to absorb the volatility that removing the AOCI filter will cause. This outcome simply fails a reasonable cost benefit analysis for insurance companies. The likely impact on consumers – increasing the cost of long-term protection products offered by affected insurance companies in response to the pressure of the increased capital – similarly fails a cost benefit test.

liabilities were held in life insurance and annuity reserves (long-term obligations), whereas 61.5% of commercial bank liabilities were held in small time and savings deposits, and checkable deposits (short-term obligations). Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States: Flows and Outstandings, Third Quarter 2011, Federal Reserve Statistical Release Z.1, December 8, 2011, table L110 (p. 73) and table L117 (p. 78).

29 Basel III NPR, 77 Fed. Reg. at 52,811.

Decreasing their holdings of long-term securities without other changes would increase maturity mismatches, significantly increasing risk.[30] Since insurers must hold long-dated assets to match their long-term liabilities, such a shift would be precisely at odds with the preferences of state insurance regulators, and would unequivocally decrease the safety and soundness of insurers themselves by making it more difficult for them to engage in effective asset-liability management. It would seem to be precisely contrary to the purpose of the proposed capital rules to incent companies to increase risk in this way.

Decreasing their holdings of long-term assets without increasing risk would force insurance companies to reduce or eliminate the offering of products for which effective asset-liability management techniques are essential, such as long-term retirement products, including annuities. Applying the proposed capital standards to achieve this outcome reduces the stable, reliable choices that consumers have to fund their retirements, at the same time that public policy cries out for stable retirement solutions.

Regardless of how it is achieved, the magnitude of such a shift away from investing in long-term assets cannot be overstated, as insurers are currently one of the most important sources of long-term credit in the U.S. economy. By way of example, life insurers held approximately $2.5 trillion of bonds in their general accounts in 2010, and 62 percent of these holdings were in bonds with maturities of 10 years or more.[31] These figures illustrate the importance of insurers in general to the flow of long-term credit in the economy, and demonstrate the magnitude of the potential impact if insurers affiliated with depository institutions are forced to shift their balance sheets away from such holdings.

In the preamble to the Basel III NPR, the Agencies seek comment on alternatives to the proposed treatment of unrealized gains and losses on AFS securities. In particular, the Agencies seek comment on an approach where unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate would be excluded from a banking organization's regulatory capital. We strongly support the exclusion of unrealized gains and losses related to all long-term debt securities, including long-term debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate, including but not limited to long-term Treasuries, securities issued or guaranteed by Fannie Mae and Freddie Mac, long-term obligations of U.S. states and municipalities and long-term investment grade debt securities. We submit that an exclusion of unrealized gains and losses from long-term debt securities from regulatory capital is not only appropriate for insurers given the differing nature of their liabilities and balance sheets when compared to traditional banking organizations, but is also integral to ensuring that insurers do not suffer disproportionate negative impacts from the imposition of the Basel III framework. The proposed removal of the AOCI filter is yet another example of the inadequacy of the proposed rules for BHCs and SLHCs that are primarily insurance enterprises, and another illustration of the need for the Board to adopt capital standards that are appropriate to the business and risks of those firms.

2. Corporate Exposures

The Proposal would assign a 100 percent risk weight to all corporate exposures, including fixed income securities issued by corporations.

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[30] See: Footnote 4, *supra.*

[31] *See* ACLI, *2011 Life Insurers Fact Book* 8, *available at* http://www.acli.com/Tools/Industry%20Facts/Life%20Insurers%20Fact%20Book/Documents/2011%20Fact%20Book.pdf.

We submit that it would be inappropriate to assign a 100 percent risk weight to investment grade fixed income securities issued by a corporation and held by a BHC or SLHC that is predominantly an insurance enterprise. Assigning a 100 percent risk weight to such exposures would have a disproportionately negative effect on BHCs or SLHCs engaged in insurance activities. Because of their need to match long-term liabilities to long-term assets, BHCs or SLHCs that are predominantly insurance enterprises hold significantly larger portfolios of long-term fixed income securities than banking organizations do. By way of example, corporate debt securities represent the largest component of life insurer assets, with life insurers holding approximately $1.7 trillion in fixed income securities at the end of 2010.[32] In light of their unique liability structure, these substantial holdings of fixed income securities are risk-mitigating, rather than risk enhancing, for insurance companies. The Board must take this into account when assigning risk weights to investment grade fixed income securities held by BHCs or SLHCs that are predominantly insurance enterprises.

3. Securitization Exposures

The Standardized Approach NPR provides that banking organizations may apply the simplified supervisory formula approach ("SSFA") or the gross-up approach to the risk weighting of securitization exposures. In the alternative, banking organizations may choose to apply a uniform 1,250 percent risk weight to securitization exposures. To calculate risk-weighted assets under the SSFA, banking organizations would apply a formula that started with the baseline derived from the capital requirements that apply to all exposures underlying a securitization, and would then assign risk weights based on the subordination level of the exposure. To calculate risk-weighted assets under the gross-up approach, banking organizations would be required to determine four inputs: the *pro rata* share, the exposure amount, the enhanced amount, and the applicable risk weight.

The Standardized Approach NPR would also require that banking organizations satisfy specific due diligence requirements for securitization exposures. Banking organizations would be required to demonstrate to the satisfaction of their primary federal supervisors a comprehensive understanding of the features of a securitization exposure that would materially affect the performance of the exposure. Demonstrating a comprehensive understanding would require banking organizations to conduct and document an analysis of the risk characteristics of the exposure prior to acquisition and periodically thereafter, and to consider as part of this analysis various factors including structural features of the securitization that would materially impact the performance of the exposure, relevant information regarding the performance of the underlying credit exposure and relevant market data on the securitization. If banking organizations were not able to demonstrate a comprehensive understanding of a securitization exposure to the satisfaction of its primary federal supervisor, they would be required to assign a risk weight of 1,250 percent to the exposure.

We are concerned that insurers may not have sufficient information to conduct the required due diligence or calculate risk-weighted assets associated with securitization exposures. With respect to the due diligence requirements, the Proposals appear to contemplate a due diligence regime designed for broker-dealers or other primary market participants that have ready access to comprehensive information about a securitization exposure and its underlying assets/exposures. It would be inappropriate to require insurers to adhere to such a due diligence regime, as insurers are secondary market participants and therefore clearly occupy a different position in the securitization market than broker-dealers or other entities that have comparatively easier access to data on securitizations. In particular, insurers may not have sufficient information about the collateral underlying their securitization exposures, and to require insurers to obtain this information would be to impose an excessive burden. Because traditional banking organizations originate the vast

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[32] *Id.*

majority of the loans that are securitized, they have ready access to the granular and specific loan origination data, including collateral data, needed to calculate risk-weighted assets associated with the exposure. As part of their loan origination and securitization activities, these banking organizations have already constructed the MIS systems and compliance infrastructure necessary to aggregate and analyze this data. Insurers, by contrast, do not originate the loans that are securitized, and hence do not have the information needed to obtain data on the securitization vehicle whenever the insurer's investment in the securitization is made. This dichotomy in data collection capability places insurers at a significant disadvantage relative to traditional banking organizations, and will make it substantially more difficult for insurers to calculate risk-weighted assets associated with securitization exposures.

Insurers primarily invest in high quality securitization exposures, and do so within the context of robust existing regulatory frameworks. For example, under existing SAP accounting rules, insurers are required to perform extensive analyses with respect to potential securitization exposures, and must hold an amount of capital based on the underlying risk of the exposure.[33] Two recent NAIC studies demonstrated that 95 percent of insurer investments in commercial mortgage-backed securities and 80 percent of insurer investments in residential mortgage-backed securities received either the highest or second highest NAIC-assigned ratings.[34] These studies reflect post-crisis improvements in insurers' methodologies for assessing the credit quality of securitization exposures, and demonstrate that insurers both understand the credit risk inherent in securitization exposures and are committed to holding adequate capital for these exposures.

The above demonstrates that insurers' existing data collection capabilities already allows them to gather adequate information and conduct substantial due diligence with respect to securitization exposures. These processes have resulted in enhanced transparency and oversight and improved valuation process with respect to insurers securitization exposures. More generally, these processes reflect a commitment on the part of the insurance industry to conducting securitization activities in a safe and sound manner. We request that the Agencies recognize the sufficiency of these existing processes, and provide for a methodology based on existing insurance regulatory frameworks pursuant to which insurers will be permitted to calculate risk-weighted assets for securitization exposures.

4. <u>Risk Weighting for Sovereign Exposures</u>

The proposed risk weighting for non-U.S. sovereign exposures requires SLHCs and BHCs to assign risk weights to sovereign exposures based on the Country Risk Classification applicable to the sovereign, which can produce risk weights ranging up to 150 percent, as opposed to zero percent for U.S. government exposures. The proposed rule exempts certain non-U.S. sovereigns from this risk weighting if certain conditions are met, including that the regulated SLHC or BHC has at least an equivalent amount of liabilities in the sovereign's currency, and that the risk weight is not lower than the one the sovereign allows the BHC or SLHC under its jurisdiction to assign to such exposures. SLHCs that are primarily engaged in insurance activities may have subsidiaries that are non-U.S. insurance companies. Those insurance companies frequently rely heavily on local sovereign bonds to back their insurance liabilities. Our comments in this letter have urged the Board to revisit the

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33 *See, e.g., Statement of SAP No. 43 – Revised: Loan-Backed and Structured Securities.*

34 *See* NAIC, *Modeling of U.S. Insurance Industry's Holdings in Commercial Mortgage-Backed Securities*, available at http://www.naic.org/capital_markets_archive/120626.htm; *Modeling of U.S. Insurance Industry's Holdings in Residential Mortgage-Backed Securities, available at* http://www.naic.org/capital_markets_archive/120601.htm.

larger question of appropriate capital standards for BHCs and SLHCs that are primarily engaged in insurance activities, and we respectfully suggest that as part of that larger undertaking, the exemption for non-U.S. sovereign exposures be modified in two respects. First, we recommend that the criterion that the BHC or SLHC have liabilities in the same currency should be modified to include liabilities of the entity's non-U.S. insurance affiliate, and second, the criterion regarding risk weighting should be revised to include risk weighting by the non-U.S. insurer's regulator, rather than only risk weighting by the banking regulators of the sovereign.

5. Supplementary Leverage Ratio for Advanced Approaches Institutions

We recognize that the supplementary leverage ratio for advanced approaches institutions would not likely be applicable to any savings and loan holding companies that are predominantly engaged in insurance activities, but we wish to point out the defects in the proposed rules in this area as yet another example of the need to separately propose capital standards applicable to savings and loan holding companies that are predominantly engaged in insurance activities.

The proposed rule introduces a supplementary leverage ratio for advanced approaches institutions. This supplementary leverage ratio is defined as the simple arithmetic mean of the ratio of tier 1 capital to total leverage exposure as calculated as of the last day of each month in the reporting quarter.

Total leverage exposure is defined as: (1) the balance sheet carrying value of all on-balance sheet assets, less amounts deducted from tier 1 capital; (2) the potential future exposure amount for each derivative contract; (3) 10 percent of the notional amount of unconditionally cancellable commitments; and (4) the notional amount of all other off-balance sheet exposures. Life insurance company separate account assets would be included in this calculation because they are on-balance sheet assets of those companies.

The proposed rules assign a zero risk weight to non-guaranteed separate accounts, recognizing that the life insurance company takes no risk relating to those assets. Similarly, non-guaranteed separate accounts should be excluded from the total leverage exposure, and therefore from the supplementary leverage ratio, for exactly the same reason: the life insurance company takes no risk relating to those assets, thus there should be no capital charge for them.

Certain other life insurance company general account assets should be excluded from the calculation of "balance sheet carrying value of all on-balance sheet assets" as well. Specifically, trading account assets supporting insurance liabilities ("TAASIL") should be excluded from this element of the calculation because the investment results of TAASIL assets are expected to ultimately accrue to the contract owners. Given the small risk to an insurer's capital from TAASIL assets, they would be more appropriately included at only a small percentage of their value, (for example, include ten percent of these assets for consistency with the factor applied to unconditionally cancellable commitments).

These are two examples of the ways that the supplementary leverage ratio for advanced approaches institutions does not adequately address the business of savings and loan companies that are predominantly engaged in insurance activities. There are other examples as well. This issue is one that would be best addressed in new capital standards that the FRB would propose for savings and loan holding companies that are predominantly insurance groups and tailored to the business models and risks of those enterprises, after a study of the insurance business.

III. Conclusion

We thank the Agencies in advance for their serious consideration of our views. We are available for further discussion on this matter at your convenience.

Respectfully submitted,

Julie A. Spiezio

Appendix AA

Proposed Approach to Consolidate Insurer Risk Based Capital
(Examples for Relatively Simple Domestic Insurance Companies)

The method assumes that a 100% NAIC RBC ratio (or 200% Authorized Control Level) calibrates to 4.5% of risk-weighted assets.**

The method to determine bank holding company capital ratios is as follows:

a. ***Numerator***: Use consolidated GAAP capital as per the NPR for all companies that report their insurance entities on a GAAP basis. For companies that only report their insurance entities on a STAT basis, they would have the option of using the more conservative Total Adjusted Capital (TAC) capital in lieu of GAAP capital for their insurance entities. Therefore, replace GAAP capital with TAC for insurance entities. For a company using TAC, surplus notes would currently need to be removed from the Tier 1 Capital calculation.

b. ***Denominator***: Use consolidated Risk-Weighted Assets (RWA) as per the NPR, except insurer portion of RWA is replaced with: 2 times Authorized Control Level (ACL) RBC divided by .045. In addition, any company using GAAP for the numerator would also need to include the insurance company assets specific to GAAP (e.g., DAC) in RWA as per the NPR.

For the denominator in this method, bank subsidiaries of insurance companies should be removed from the ACL RBC calculation in order to avoid double-counting.

Example of proposed method on a GAAP Basis ($ millions):

Consolidated GAAP Equity	**23,750**
less intangibles that do not qualify for Tier 1 capital	**(500)**
unrealized gain on available-for-sale securities	**(1,500)**
other adjustments for Tier 1 capital	**(750)**
Tier 1 Capital	**21,000**
Authorized Control Level RBC Charges	**2,100**
less ACL RBC Charges for Bank	**(1)**
Insurance only ACL RBC Charges	**2,099**
Imputed Insurer Risk Weighted Asses based on ACL RBC Charges	**93,289**
Add'l Insurer RWA attributed to DAC	**5,000**
Bank Risk Weighted Assets	**50**
Total Risk Weighted Assets	**98,339**
Tier 1 Capital to Risk Weighted Assets Ratio	**21.4%**

In the aforementioned example, the insurer owned the bank, which is the reason RBC charges were reduced (in order to avoid double counting).

Example of proposed method on a Statutory Basis ($ millions):

Example of proposed method on a STAT Basis ($ - millions)		
Total Adjusted Capital		**20,650**
Tier 1 adjustments for the bank subsidiary (e.g., goodwill)		**-**
Deduct: Surplus Notes		**(1,750)**
Capital - Tier 1		**18,900**
Tier 2 Adjustments for the bank subsidiary		**-**
Surplus Notes		**1,750**
Capital - Tiers 1 & 2		**20,650**
Authorized Control Level RBC		**2,100**
Deduct: ACL RBC held for insurer's equity in bank		**(1)**
Authorized Control Level RBC excluding Bank		**2,099**
Imputed Insurer RWA= ACL excluding Bank times 2 divided by:	**0.045**	**93,289**
Bank RWA		**50**
Total RWA		**93,339**
Capital Ratio - Tier 1		**20.2%**
Capital Ratio - Tiers 1 & 2		**22.1%**

In this example, the SAP-only insurer is at the top of the holding company structure and owns the bank.

**The rationale for selection of 200% of Authorized Control Level (ACL) RBC and calibration to Common Equity Tier 1 (CET1) of 4.5% is based on the following assessment of equivalency based on regulatory responses to breaching these thresholds.

RISK BASED CAPITAL STANDARDS
BASEL III

Common Equity Tier 1 RBC > 4.5% = Adequately Capitalized

Less than 4.5% - The Federal Deposit Insurance Act, as amended ("FDIA"), requires, among other things, that federal banking agencies take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. Undercapitalized institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized."

"Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks.

NAIC – RBC
Company Action Level 150 – 200% of Authorized Control Level

Insurer must prepare a report to the regulator outlining a comprehensive financial plan that identifies the conditions that contributed to the company's financial condition. This plan must contain proposals to correct the financial problems and provide projections of the financial condition, both with and without the proposed corrections. The plan also must visit the key assumptions underlying the projections and identify the quality of, and the problems associated with the insurers business. If a company fails to file this comprehensive financial plan, this failure to respond triggers the Regulatory Action Level. At this level, an insurance company is also required to file an action plan, and the State Insurance Commissioner is required to perform any examinations or analyses to the insurer's business and operations that he/she deems necessary. The State Insurance Commissioner also issues appropriate corrective orders to address the company's financial problems.

Appendix BB

The following example illustrates how a BHC or SLHC with an operating insurance subsidiary will be required to hold higher capital against the same assets as a BHC or SLHC without an operating insurance subsidiary.

- Company A –SLHC with an insurance operating subsidiary
- Company B – BHC with no insurance operating subsidiary

	Company A		Company B
Assets:	7,000,000		7,000,000
Type:	BBB rated Corp. Bonds		BBB rated Corp. Bonds
RBC After-tax			
C1 (Credit)	59,150		-
C2 (Insurance)	22,590		-
C3 (Interest rate, health, market)	29,180		-
C4 (Business)	7,400		-
Total	118,320		-
Total after Covariance	89,070		-
Authorized Control Level (50%)	44,535		-
Attributable to:			
Credit	25,270		
Interest Rate, Market	9,180		
Total Asset Risk	34,450		
Insurance and Business Risks	10,085		
Risk Weighted Assets	7,000,000		7,000,000
Total Minimum Capital Requirement 8%	560,000		560,000
Total Capital Requirement			
2x Authorized Control Level	89,070		
Attributable to:			
Credit	50,540		-
Interest Rate, Market	18,360		
Total Asset Risk	68,900		
Insurance and Business Risks	20,170		-
Minimum 8% RWA	560,000		560,000
TOTAL	**649,070**		**560,000**
Attributable to Asset Risks	**628,900**		**560,000**
Attributable to Insurance Risks	20,170		-

In the above simplified example, each Company owns a portfolio of BBB rated corporate bonds valued at $7 million dollars, which are risk-weighted at 100%. Thus, under the Proposals, Company B would be required to hold $ 560k in Common Equity Tier 1 Capital, Additional Tier 1 Capital, and Tier 2 Capital against these assets to meet the 8% Total RBC ratio. However, Company A, which is required to deduct from Total Capital 200% (or 2x) the subsidiary's authorized control level risk-based capital, would be required to hold $649,070 (or an additional $89,070) in Total Capital against the exact same assets.