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October 22, 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. 1438 & RIN 7100-AD-86); Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (FRS Docket No. 1438 & RIN 7100-AD-86); Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule (FRS Docket No. 1438 & RIN 7100-AD-86)[1]

Dear Sirs:

We are Chief Financial Officers of a coalition of domestic insurance companies (the Coalition) who share concerns with the Federal banking agencies' (collectively, the Agencies) release of the three notices of proposed rulemaking (the Proposals) implementing the Basel III capital framework in the United States. We appreciate the opportunity to submit comments. The stated goals of the Proposals are to implement the capital reforms outlined in Basel III and the changes to the Agencies' capital standards

[1] 77 F.R. 52792 (Aug. 30, 2012); 77 F.R. 52888 (Aug. 30, 2012); 77 F.R. 52978 (Aug. 30, 2012).

required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA). While we understand the need for these reforms and support the Agencies' efforts to enact strong capital standards for financial institutions, we have concerns with the approach the Agencies have taken in imposing bank-centric capital standards on Federal Reserve Board (Board) supervised insurance organizations (insurance organizations) and the approach the Proposals take to the business of insurance generally. These concerns apply to both insurance organizations that own depository institutions and insurance companies that may be subject to capital requirements as systemically important financial institutions (SIFIs).

The business of insurance differs fundamentally from other areas of the financial services sector. The Coalition believes that the Proposals' failure to account for the fundamental differences between insurance and banking will harm the insurance industry and the broader economy, and thus hinder the Agencies' efforts to promote financial stability and economic growth. We therefore are asking that the Agencies 1) strongly consider the intent of and written requests from Congress to accommodate the business of insurance without negatively impacting the economy;[2] 2) carefully consider the impacts of these actions on the insurance industry by conducting a quantitative impact analysis; and 3) directly engage the industry with respect to their detailed company comment letters as the final rules are developed.

The Collins Amendment

The Coalition shares the concerns expressed by the Financial Services Roundtable (FSR), the American Council of Life Insurers (ACLI) and other industry associations that the Proposals would require all insurance organizations subject to the Board's supervision, regardless of size, to meet new minimum capital requirements beginning January 1, 2013.[3] We believe there are numerous reasons why applying such metrics to insurance organizations will undermine the very results the Agencies are trying to achieve. Regardless of what standards ultimately are applied, an adequate transition period is critically important. The Board itself has acknowledged that certain insurance organizations will require a transition period to build a second accounting system to produce requisite financial reporting and to produce information required to calculate the proposed ratios.

Congress articulated its intent to provide insurance organizations until 2015 to come into compliance with the capital standards in Section 171(b)(4)(D) of DFA (part of the "Collins Amendment"). The Collins Amendment provides that for any depository

[2] See October 15, 2012 letter from Ranking Member of the Senate Banking Committee, Richard Shelby; and the October 17, 2012 bipartisan Senator Sherrod Brown (D-OH) and Mike Johanns (R-NE) U.S. Senate letter signed by 24 Senators.

[3] The reporting for compliance with these new capital standards would begin with the March 31, 2013 FR Y-9C filing.

institution holding company that was not supervised by the Board as of May 19, 2010, the capital requirements shall be effective five years after the enactment of DFA or July 21, 2015. The language of Section 171(b)(4)(D) is essentially identical to the language of DFA Section 171(b)(4)(E), which affords U.S. bank holding companies (BHCs) that are subsidiaries of foreign banking organizations and rely on the Board's Supervision and Regulation Letter SR 01-01 (SR 01-01 Entities) until July 21, 2015, to comply with the Proposals' capital requirements. The Agencies provide SR 01-01 Entities the full five-year transition period, stating that such approach is ***consistent*** with the Collins Amendment, but they fail to extend the same treatment to insurance organizations, an approach we argue is ***inconsistent*** with the Collins Amendment.[4] We do not believe there is a sound public policy reason for the disparate treatment between insurance organizations and SR 01-01 Entities.

Section 171(b)(4)(D) highlights Congressional recognition that because insurance organizations never before have 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 for Section 171(b)(4)(E), as SR 01-01 Entities are not subject to consolidated capital requirements in the United States and therefore require a similar extended transition period. Because insurance organizations and SR 01-01 Entities are similarly situated, it is unsurprising that the language of sections 171(b)(4)(D) and 171(b)(4)(E) are almost identical. Given Congress' clear intent to provide for similar transition periods for both classes of institutions, we believe that the final rules should afford both types of entities the full transition period. In fact, there are significant policy reasons to recognize the full five-year transition period as accelerated implementation will itself create prudential implementation risks.

The Business of Insurance is Fundamentally Different from Banking

The Basel capital framework focuses substantially on assets (rather than a more holistic approach that recognizes the value of stable liabilities or financing concerns). To understand fully the capital adequacy needs of an insurance organization, it is imperative that any capital framework designed for insurance organizations consider an insurer's liabilities and how the insurer reserves for those liabilities – as does the current state risk-based capital (RBC) framework. We believe the final rules should recognize the importance of asset-liability matching, one of the most important elements of insurer risk management.

For insurance organizations, a key concern is solvency and the ability to pay policyholders over long periods in contrast to the short-term liabilities of banks. Premiums are collected in advance and invested ahead of anticipated claims, insurers have relative predictability of those claims, and insurance products have safety mechanisms such as surrender charges to protect against early liquidity demands. Unlike

[4] 77 F.R. at 52795.

banks, which largely are funded by immediately payable 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. For 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 2011.[5] In light of the insurance company liability structure, these substantial holdings of fixed income securities are risk-mitigating, rather than risk-enhancing.

It is also important to note that one of the fundamental differences between bank depositors and insurance company policyholders is intent. Insurance policyholders purchase protection with a future-oriented time horizon, while bank customers typically invest for safety and convenience, and in some circumstances, yield. Subsequently, insurers do not face a comparable "run-on-the-bank" risk scenario. Property-casualty policies generally require the occurrence of an insured event before payment is owed. Some types of life and annuity policies can be cashed in, but only with significant withdrawal penalties. Thus, there is generally very little incentive for customers to terminate their life and annuity policies, and this is precisely the historical experience to date. Insurance liabilities exhibit stability and relative illiquidity that fundamentally differentiate them from bank deposits. For this reason, the regulatory goal of consumer protection leads to a focus on long-term solvency.

Two of the primary functions of capital standards for financial institutions are to 1) set triggers for supervisory action leading up to and including liquidation/resolution; and 2) protect consumers from loss in the event of insolvency. Unlike bank deposits, insurance liabilities do not put the FDIC insurance fund at risk. There is a separate state-based resolution regime for insurance, which is maintained under the DFA.[6] This state-based regime consists of industry-funded guaranty funds and, as a result, prevents the federal government from needing to provide a backstop for policyholder obligations. Because the guaranty funds are funded by the industry itself and the failure of one insurer is borne by the entire industry, guaranty funds create an industry-wide incentive for insurers to monitor the effectiveness of the capital rules to which they are subject. This backstop often goes unnoticed and is little known among consumers since insurers are prohibited from publicly discussing or marketing these protections.

Implications of the Proposals on Insurance Organizations

Set forth below are specific aspects of the Proposals that are particularly inappropriate for insurance organizations and demonstrate why these Proposals do not accurately reflect the business of insurance.

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[5] ACLI Investment Bulletin, "Invested assets portfolio profile year end 2011." (August 2012) (Data from NAIC annual statutory filings).

[6] See section 203(e) of DFA.

Transition Time. The Proposals provide a proposed effective date of January 1, 2013, for insurance organizations, which is inconsistent with the Collins Amendment. Such companies have never been subject to Basel requirements and this extremely short transition period is unduly burdensome and contrary to the express intent of Congress in the Collins Amendment. Furthermore, the proposed rules would require the implementation of GAAP accounting standards by January 2013, which is simply infeasible for insurers not currently reporting under GAAP. There is insufficient time for insurers to implement the systems and processes necessary to provide the data required by the Proposals.

Double-counting of Assets. The Proposals would require an insurance organization to deduct from its consolidated capital ratios an amount equal to the minimum regulatory capital requirement established by the regulator of any insurance underwriting subsidiary. This amount generally would be 200% of the subsidiary's authorized control level RBC (as defined by an insurance company's regulatory capital requirements). As a result of this requirement, assets owned by an insurance underwriting subsidiary would be considered within the context of the capital requirements of both the insurance company RBC requirements and the insurance organization's capital requirements. Therefore, the insurance organization would risk-weight assets in its Basel capital requirements that already have been considered for purposes of establishing its insurance underwriting deduction. This results in the same asset being risk-weighted twice – once as a holding of the insurance subsidiary and a second time as a consolidated holding of the insurance organization (as owner of the insurance subsidiary).

The state-based regulatory RBC regime captures a number of risk exposures tailored to insurance companies, including asset risk, insurance/underwriting risk, interest rate risk, and business risk. By contrast, the Basel capital framework essentially measures asset risk and was developed specifically for the asset profile of banks. Moreover, the insurance RBC framework is tailored to account for different types of insurance such as life, health and property casualty. The bank capital rules fail to make a similar distinction.

Separate Accounts. The Proposals provide that the risk weight applied to separate account assets will depend on whether or not the separate accounts are considered "non-guaranteed." If the separate account is considered "non-guaranteed," then the separate account assets will get a 0% risk weight. If the separate account assets are not considered "non-guaranteed," then they will be treated as if they were general account assets and risk-weighted based on the underlying assets.

First, the definition of "non-guaranteed" is overly broad and it threatens to include contractual commitments on separate account products that are not guarantees of the value of the separate account assets, but are promises to pay an additional benefit in the event of an insurable event. These contractual commitments are reflected in the insurers' general account reserves and backed by general account assets that are already subject to

a capital charge. Therefore, there should not be a second capital charge against the separate account assets.

Second, it makes no sense to apply a risk weight to the underlying separate account assets for those separate accounts that do not meet the definition of "non-guaranteed." While we recognize that certain separate accounts present risk to an insurer, and that it is appropriate to hold capital against those risks, the risk weight should be applied to the value of the guarantee as opposed to the value of the underlying separate account assets. Risk-weighting the value of the underlying assets in the separate account would have the counterintuitive effect of requiring higher capital when the risk posed by the guarantee is lower.

Finally, the Proposals would include insurance company separate account assets in the denominator of the proposed Tier 1 leverage ratio. This inclusion is contrary to the Financial Stability Oversight Council's determination that separate accounts are "not available to claims by general creditors of a non-bank financial company" and, therefore, should be excluded from the calculation of the leverage ratio used in the DFA Section 113 determination process.[7] Accordingly, the Proposals should be modified to exclude separate account assets from the denominator of the leverage ratio calculation.

The Proposals' treatment of separate accounts is a significant issue for insurers and individuals who rely on these products for lifetime income and retirement savings products. Variable annuity contracts funded by insurance company separate accounts are a significant investment vehicle for individuals to use for their retirement savings. As of 2010, $1.3 trillion was invested in 32.4 million variable annuity policies.[8] We believe the inappropriate treatment of separate account assets could have significant anti-competitive implications and a detrimental consumer impact.

Conclusion

The Coalition wishes to express our support for capital adequacy rules appropriate to insurance organizations. We urge the Agencies to further study the impact of the proposals and engage the industry directly to arrive at final regulations that both strengthen the economy and appropriately accommodate the business of insurance. The insurance industry is an important investor for long-term corporate debt and equity, municipal bonds, and other long-dated securities such as commercial mortgage loans. The imposition of a bank-centric capital framework on insurance organizations would be duplicative, unduly burdensome and costly, and may drive insurers to make business decisions based on a capital framework that does not adequately assess their risks. This

[7] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 F.R. 21,637, 21,661 (Apr. 11, 2012).

[8] ACLI Product Line Report: Annuity Insurance (January 2012) ("ACLI Annuity Report").

could cause negative distortions in the marketplace, introduce more risk into the financial system and increase costs for customers/policyholders.

We thank the Agencies for their serious consideration of our views. We look forward to further discussions of these important regulations.

Respectfully,

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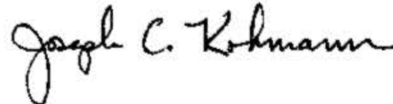

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