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July 28, 2011

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., N.W.
Washington, D.C. 20551

Re: Proposed Rule on Capital Plans (*Docket No. R-1425; RIN No. 7100 AD 77*)

Dear Chairman Bernanke:

These comments are submitted on behalf of the American Council of Life Insurers ("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. On behalf of all our members, we appreciate the opportunity to submit comments on the proposed rule for capital plans (the "Proposed Rule") referenced above as proposed by the Board of Governors of the Federal Reserve System (the "Board") and published at 76 Federal Register 35351 (June 17, 2011).

The Proposed Rule would require top-tier U.S. bank holding companies with total consolidated assets of $50 billion or more to submit capital plans to the Board on an annual basis and to provide prior notice to the Board under certain circumstances before making a capital distribution. In its press release accompanying the Proposed Rule, the Board notes that the Proposed Rule builds upon and institutionalizes the Comprehensive Capital Analysis and Review conducted earlier this year at the 19 largest U.S. bank holding companies.[1] Based on the most recent available data, there are approximately 35 U.S. bank holding companies with $50 billion or more in consolidated assets that would be covered by the Proposed Rule. In the Supplementary Information section of the Federal Register notice, the Board indicates that through separate rulemaking or by order, it expects that the requirements of the Proposed Rule would be extended to large savings and loan holding companies and nonbank financial companies supervised by the Board pursuant to section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2]

A number of ACLI member companies own insured savings associations and thus may become subject to any future extension of the Proposed Rule to large savings and loan holding companies or nonbank financial companies supervised by the Board pursuant to section 113 of the Dodd-Frank Act. Because of the implications of any possible future extension of the Proposed Rule to large savings and loan holding companies, particularly those that are predominantly engaged in insurance activities or have significant insurance operations, or

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1 Federal Reserve Press Release (June 10, 2011).
2 76 Fed. Reg. 35351, 35352 n.9 (June 17, 2011).

nonbank financial companies, the ACLI is offering its comments on the Proposed Rule. The predominant insurance nature of the ACLI member companies that own depository institution subsidiaries provides an important perspective for commenting on any possible future extension of the Proposed Rule to savings and loan holding companies or nonbank financial companies supervised by the Board pursuant to section 113 of the Dodd-Frank Act.[3]

1. General Observations on a Supervisory Approach to Savings and Loan Holding Companies

As the ACLI has noted in earlier comment letters to the Board,[4] the ACLI believes that the Board should recognize as a basic principle in any supervisory approach to savings and loan holding companies that many savings and loan holding companies, particularly those that are predominantly engaged in insurance activities, have significantly different business and risk profiles than the bank holding companies that the Board has traditionally regulated. In addition, many savings and loan holding companies own savings associations that represent a very small percentage of assets or revenues of their overall corporate entity. This is particularly true of savings and loan holding companies that are predominantly insurance enterprises and distinguishes these savings and loan holding companies from virtually all bank holding companies for which the depository subsidiaries represent a predominant percentage of the assets and revenues of the overall corporate entity. In developing an appropriate supervisory approach to savings and loan holding companies and nonbank financial companies, the Board must recognize the different business models and risk profiles that distinguish many large savings and loan holding companies and other nonbank financial companies from large bank holding companies and tailor its supervisory approach to the specific business models and risk profiles of the entities to be supervised.

This approach has the clear advantage of structuring a supervisory program to the actual risk characteristics of the entities to be supervised rather than to a model that no matter how well designed or accepted does not reflect the characteristics (either in terms of diversity of activities or the relative weight of depository activities) of the entities to be supervised. This tailored approach also allows for differentiated supervision of organizations that are low-risk or noncomplex irrespective of size. This tailored approach has the additional advantage of allowing the necessary and appropriate weight to be accorded to the existing regulatory regimes that apply to particular types of financial entities such as insurance companies. These general principles guide the following comments from the ACLI with respect to the possible future extension of the Proposed Rule to large savings and loan holding companies and other nonbank financial companies that are predominantly insurance enterprises or have significant insurance operations.

[3] While the comments in this letter focus primarily on the issues related to any potential extension of the Proposed Rule to savings and loan holding companies that are predominantly insurance enterprises, the comments are also relevant to the issues of the application or extension of the Proposed Rule to any entity that is predominantly an insurance enterprise or has significant insurance operations, including an entity that is a bank holding company or a nonbank financial company supervised by the Board pursuant to section 113 of the Dodd-Frank Act.

[4] *See* ACLI Letter to Hon. Ben S. Bernanke (April 6, 2011);
ACLI Letter to Hon. Ben S. Bernanke (May 20, 2011).

2. Savings and Loan Holding Companies Predominantly Engaged in Non-Depository Activities

As the Board has consistently noted in its supervisory guidance relating to the payment of dividends and the redemption and repurchase of stock by bank holding companies, "[a] fundamental principle underlying the Federal Reserve's supervision and regulation of BHCs is that a BHC should serve as a source of management and financial strength to its subsidiary banks."[5] Indeed, much of the Bank Holding Company Act regime is focused on protecting the safety and soundness of the subsidiary banks of the holding company.[6] A supervisory approach to capital planning at a holding company level, including a capital plan requirement, is consistent with these objectives when the depository subsidiary or subsidiaries represent a significant percentage of the overall assets or revenues of the holding company.

The supervisory approach should be modified, however, when the depository subsidiary or subsidiaries represent a relatively small percentage of the consolidated holding company entity. In such a case, the assets available to the holding company to provide additional capital or other financial support to the depository subsidiary may be many times the amount of any additional capital requirement at the depository subsidiary. In addition, in the case of a large holding company with a small depository subsidiary, there will be much reduced risk of reliance on dividends from the depository subsidiary to service the obligations at the holding company level (and much reduced risk of any problem arising from double leverage at the holding company level).[7] As a structural matter, a large savings and loan holding company with a small depository institution is inherently better aligned with the source-of-strength doctrine than the typical large bank holding company with a large depository subsidiary or subsidiaries. To subject a large holding company with a small depository subsidiary to a regulatory requirement for a formal capital plan and for review and non-objection by the Board is thus unnecessary and disproportionate to the intended purpose and does not make the appropriate allowance for the differences between the financial profile of large bank holding companies and most large savings and loan holding companies.

As part of its supervisory responsibility over savings and loan holding companies, the Board will have the full range of other supervisory and regulatory tools to assess and monitor the capital position of savings and loan holding companies. These supervisory and regulatory tools can be more appropriately tailored to the individual situation of savings and loan holding companies than a capital plan requirement. The ACLI encourages the Board to consider the appropriate range of supervisory and regulatory tools available to it to monitor the capital positions of savings and loan holding companies and to tailor its approach to the differing situations of individual savings and loan holding companies.

The use of a tailored approach to capital monitoring for savings and loan holding companies is also consistent with another principle articulated by the Board in issuing the Proposed Rule, i.e., that the amount of capital held by a holding company should be commensurate with the

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[5] *See* Division of Banking Supervision and Regulation SR Letter 09-4 (Feb. 24, 2009) (revised March 27, 2009); Federal Reserve Board Policy Statement, Unsafe Banking Practices – Cash Dividends Not Fully Covered by Earnings (Nov. 14, 1985). The Dodd-Frank Act has now extended the source of strength doctrine to all holding companies of insured depository institutions. *See* Dodd-Frank Act § 616(d).

[6] *See* Bank Holding Company Supervision Manual §1050.1 (Jan. 2009).

[7] In the case of a savings and loan holding company, the Home Owners' Loan Act of 1933 ("HOLA") already provides a direct mechanism for regulatory review of all dividend payments to the holding company. *See* 12 U.S.C. § 1467a(f). The Office of Thrift Supervision has by regulation expanded the review process beyond dividends to all forms of capital distributions (other than dividends payable in shares) by a savings association subsidiary to its holding company. *See* 12 C.F.R. §§ 563.141-536.146.

company's risk profile. Many large savings and loan holding companies have risk profiles that differ significantly from large bank holding companies. For example, the largest bank holding companies are engaged in various financial activities that the Congress identified as posing significant risks to the financial system, such as acting as primary dealers, acting as derivatives dealers, managing payment and clearing systems, providing prime brokerage services, and sponsoring and underwriting structured products. Many savings and loan holding companies are not engaged in these activities at all or only to an insignificant extent in the case of individual institutions. The significant difference in the risk profiles of large bank holding companies and large savings and loan holding companies should be recognized in any supervisory approach that the Board adopts, providing for a tailored assessment of the risk profiles of individual large savings and loan holding companies.[8] As discussed in the following section, recognition of the difference in risk profiles between large bank holding companies and large savings and loan holding companies is particularly appropriate for large savings and loan holding that are predominantly engaged in insurance activities or have significant insurance operations.

3. Special Considerations Applicable to Savings and Loan Holding Companies Predominantly Engaged in Insurance Activities

Within the set of large savings and loan holding companies, special considerations apply to those savings and loan holding companies that are predominantly engaged in insurance activities. In effect, these entities represent a unique subset of institutions because of the nature of their business and the attendant regulatory structure that flows from that business. Consistent with the underlying approach reflected in the Dodd-Frank Act, the Board in developing its supervisory approach to large savings and loan holding companies should tailor its approach to the predominant line of business of the savings and loan holding company. This is particularly appropriate for savings and loan holding companies that are predominantly engaged in insurance activities because of the longstanding and comprehensive regulatory and supervisory system that applies to entities engaged in insurance activities. The amendments made to HOLA by the Dodd-Frank Act recognize this principle as applied to savings and loan holding companies that own functionally regulated subsidiaries.[9]

As the ACLI has noted in an earlier comment letter, any supervisory capital approach developed by the Board for savings and loan holding companies that are predominantly engaged in insurance activities must take full account of the "inherent differences" between the insurance and banking businesses and the resulting differences in the risk-based capital methodology

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[8] In issuing the Proposed Rule, the Board noted that while the proposal is not mandated by the Dodd-Frank Act, the Board believes that it is appropriate to hold large bank holding companies to an elevated capital planning standard because of the elevated risk posed to the financial system by large bank holding companies. The Board also noted that the proposed asset threshold of $50 billion for bank holding companies is consistent with the threshold established by section 165 of the Dodd-Frank Act relating to enhanced prudential supervision for large, interconnected bank holding companies. 76 Fed. Reg. at 35352. It should be noted, however, that neither section 165 nor section 166 of the Dodd-Frank Act, which is also cited by the Board in Supplementary Information section of the Proposed Rule, apply to savings and loan holding companies as such. Likewise, the related sections 115 and 116 of the Dodd-Frank Act do not apply to savings and loan companies as such, reflecting Congressional recognition that large savings and loan holdings generally present a different risk profile than large, interconnected bank holding companies.

[9] *See* Dodd-Frank Act § 604(g) & (h).

adopted by the insurance and banking regulators.[10] As the ACLI has further noted, the best way to address the inherent differences between the insurance and banking business would be to recognize and accept for supervisory purposes to the greatest extent possible the insurer risk-based capital requirements for savings and loan holding companies that are predominantly engaged in insurance activities.[11] As discussed below, the insurance regulatory system provides both for required capital levels <u>and</u> controls on dividend payments by insurers. These are essential elements of the insurance regulatory system for insurers. They should also be recognized as essential elements of any supervisory system that the Board implements for savings and loan holding companies that are predominantly engaged in insurance activities. The following discussion provides a high level summary of the relevant capital requirements and dividend restrictions applicable to insurance companies under state insurance law and regulation.

A. *Insurer Risk-Based Capital*

Under state law insurers are subject to conservative risk-based capital ("RBC") requirements that take into account both investment (asset) and insurance (liability) risks as well as interest rate risk, off balance sheet items like guarantees and contingent liabilities and the risk of collectability of reinsurance. If an insurer's RBC ratio (Total Adjusted Capital/Authorized Control Level RBC) falls below 200%, the insurer must present its domestic state insurance regulator with a plan to improve its financial position. The insurer's domestic state insurance regulator is authorized to place an insurer in receivership if the RBC ratio falls below 100%, and is required to place the insurer into receivership if the RBC falls below 70%.[12] A well-capitalized insurer generally holds multiples of the required RBC level. It is important to note that the insurer RBC calculation is formulaic, and is not based on insurer's own risk estimates or internal models.

While insurer RBC is important generally to the financial health of a top-tier depository institution holding company that owns both an insurer and an insured depository institution, insurer RBC takes on additional importance when an insurer itself owns, directly or indirectly, the insured depository institution. This will be the case for all top-tier depository institution holding companies that are mutual insurers. Since mutual insurers and fraternal benefit societies have no parent, they are the top-tier depository institution holding company. In addition, this will be the case for a top-tier depository institution holding company that owns a stock insurer that, in turn, directly or indirectly, owns an insured depository institution. In this case, the capital standards imposed by insurer RBC indirectly supports the continued financial health of the depository subsidiary.

B. *Stock Insurer Shareholder Dividend Limitations*

State insurance laws typically include regulation of shareholder dividends made by stock insurers. These are usually contained in state insurance holding company statutes. The typical law[13] requires the following:

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[10] *See* ACLI Letter to Hon. Ben S. Bernanke (May 20, 2011) (quoting from the Report of the National Association of Insurance Commissioners (NAIC) and the Federal Reserve System Joint Subgroup on Risk-Based Capital and Regulatory Arbitrage (May 24, 2002).

[11] Id.

[12] *See* National Association of Insurance Commissioners, Risk-Based Capital (RBC) Model Act §§ 3-5.

[13] *See, e.g.*, Ill. Rev. Stat. Ch. 215 §§ 5/27 (earned surplus) 5/131.20a(2) (extraordinary dividend) and 50 Ill. Adm. Code 855.30(a)(1) (ordinary dividend).

(i) All shareholder dividends be paid only from earned surplus (accumulated earnings) and not contributed surplus (proceeds from the sale of its stock). Some states may allow shareholder dividends to be paid from other than earned surplus but only with the prior approval of the insurer's domestic state insurance regulator.[14]

(ii) No "extraordinary dividend" may be paid without giving the domestic state insurance regulator at least 30 days prior notice, during which time the regulator may disapprove the proposed shareholder dividend. An "extraordinary dividend" is typically defined as one, which together with other dividends made within the prior 12 months, exceeds the greater of (i) 10% of the insurer's surplus as of the prior December 31, or (ii) the net income of the insurer for the 12-month period ending the prior December 31.

(iii) The insurer must give its domestic state insurance regulator notice of each and every "ordinary dividend" – any dividend that is not an "extraordinary dividend." A typical state law or regulation may require notice 5 business days following declaration of the ordinary dividend and no less than 10 business days prior to payment of the ordinary dividend. This allows the regulator to review the impact of the proposed ordinary dividend on the financial condition of the insurer and, if warranted, allow the regulator to intervene and prohibit the ordinary dividend.[15]

These state law restrictions serve the same general purpose as the restrictions in banking law on the payments of dividends. They are used when necessary to preserve the financial strength of the insurance subsidiary; they also serve as a prophylactic matter to discourage undue reliance by a holding company on dividends or other distributions from an insurance subsidiary. If a savings association subsidiary is owned directly or indirectly by an insurance company, they can also serve indirectly to discourage undue reliance by the holding company on dividends or capital distributions from the savings association subsidiary in conjunction with the direct regulatory regime applicable under HOLA.

C. *Policyholder Dividends*

If the Proposed Rule were to be extended to savings and loan holding companies that are mutual insurance companies or mutual insurance holding companies, it could present significant problems for such entities. The Proposed Rule contains a broad definition of the term "Capital distribution" to mean:

> "a redemption or repurchase of any debt or equity capital instrument, a payment of common or preferred stock dividends, a payment that may be temporarily or permanently suspended by the issuer on any instrument that is eligible for inclusion in the numerator of any minimum regulatory capital ratio, and any similar

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[14] *See, e.g.*, Pa. Stat. Ann. Tit. 40, § 459.8(a), (b).

[15] In addition, if an insurer's domestic state insurance regulator determines that the continued operation of the insurer may be hazardous to the policyholders or the general public, then the regulator may issue an order requiring the insurer to, among other things, suspend or limit the declaration and payment of dividend by an insurer to its stockholders or to its policyholders. *See* National Association of Insurance Commissioners, Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition § 4.B(5).

transaction that the Federal Reserve determines to be in substance a distribution of capital."[16]

Mutual insurers and mutual insurance holding companies regularly pay "dividends" to their policyholders or members. However, these are not distributions on any capital instrument. Policyholders and members are neither shareholders nor debt holders in that capacity. Nonetheless, the ACLI is concerned that the phrase "any similar transaction that the Federal Reserve determines to be in substance a distribution of capital" could be construed as including dividends to policyholders or members of a mutual insurer or a mutual insurance holding company. In no event should any proposed capital plan requirement extend to the payment of dividends to policyholders or members of a mutual insurer or a mutual insurance holding company.[17]

Policyholder dividends of mutual life insurers are already subject to regulation under state insurance laws. For example, under New York law, a mutual life insurer must ascertain the surplus earned by it each calendar year. It may then set aside from that earned surplus an amount for deferred dividend policies and an amount its deems advisable for the accumulation of surplus (capital), but then must use the remainder of the earned surplus for the payment of policyholder dividends in accordance with insurance regulatory standards.[18] As a general matter, current year policyholder dividends are paid from current year earnings.[19]

4. Phase-in for Savings and Loan Holding Companies

The Proposed Rule would apply to every top-tier bank holding company domiciled in the United States that has $50 billion or more in total consolidated assets. However, as noted in the Supplementary Information section of the Federal Register, "[c]onsistent with the phase-in period for the imposition of minimum risk-based and leverage capital requirements established in section 171 of the Dodd-Frank Act," the Proposed Rule by its terms would not apply until July 21, 2015 to any bank holding company subsidiary of a foreign banking organization that has relied on Supervisory and Regulatory Letter SR 01-01 issued by the Board.[20]

We believe that this postponement for such foreign-owned bank holding companies is appropriate both as a policy matter and as a matter of statutory intent. For the reasons discussed in the previous sections of this letter, the ACLI believes that a capital plan requirement at least in the form of the Proposed Rule should not be extended to large savings and loan holding companies. If, however, the Board should decide to extend a proposed capital plan rule to large savings and loan holding companies, the ACLI submits that the Board should provide the same phase-in period for savings and loan holding companies pursuant to section 171(b)(4)(D) of the Dodd-Frank Act as the Proposed Rule provides to bank holding company subsidiaries of foreign banking organizations pursuant to section 171(b)(4)(E) of the Dodd-

[16] 76 Fed. Reg. at 35359 (to be codified at 12 C.F.R. § 225.8(c)(2)).

[17] This same reasoning would also apply to similar types of distributions made by other insurers such as insurers operating on a not for profit basis and fraternal benefit societies.

[18] N.Y. Ins. L. § 4231(a). So that a mutual life insurer cannot accumulate an excessive amount of surplus and pay no policyholder dividends, under New York law a mutual life insurer may not maintain surplus in excess of the greater of (i) $850,000, or (ii) 10% of its policy reserves and policy liabilities, or (iii) 10% of its policy reserves and policy liabilities plus 300% of its authorized control level RBC minus the asset valuation reserve as reported in its annual statement, or (iv) the minimum amount of capital and surplus required by law of another state in which the insurer is authorized to do business. N.Y. Ins. L. § 4219(a)(1).

[19] A mutual life insurer that in good faith apportions its divisible surplus on an annual basis may pay dividends from its accumulated surplus so long as it maintains the minimum amount required by law.

[20] 76 Fed. Reg at 35352.

Frank Act. The provisions in section 171(b)(4)(D) and (E) of the Dodd-Frank Act reflect the legislative judgment that the institutions covered by these provisions should be provided with the same phase-in period before being subjected to new capital requirements. In addition, if the Board formally proposes extension of the Proposed Rule to savings and loan holding companies or other non-bank holding company entities, we respectfully request those entities be given an opportunity equal to that afforded to bank holding companies to comment on the specific rules that would apply to such entities prior to any final decision to expand their application.

5. The Capital Plan Submission Process

The Proposed Rule would generally require that capital plans be submitted to the Board by January 5th of each year and that the Board would provide a notice of non-objection by March 15th. Any effort to address concerns expressed by the Board would presumably further delay this timeframe and the associated completion of a capital plan for the year. This would significantly restrict a subject company's ability to address annual capital distributions by effectively disabling all subject companies from setting forth a final capital plan within at least the first quarter of each calendar year.

Use of the first quarter time frame for all bank holding companies, savings and loan holding companies and systemically significant nonbank financial companies is extremely disruptive to the corporate governance framework of the companies and is equally inefficient for the Board's use of its resources. The Proposed Rule establishes a timeline that is potentially unfair and adverse to the interests of shareholders and policyowners of subject companies and mandates a regulatory framework for capital distribution decisions that limits the flexibility of the subject company to deal with those plans in the ordinary course of its corporate governance process. The Proposed Rule also establishes a process that will require Board staff to review all capital plan submissions within a two month period at the beginning of each calendar year. There is no demonstrable regulatory need for such a timing requirement.

We recommend that the Board modify the Proposed Rule to permit subject companies to follow their regular corporate governance timeline for development of capital distribution plans and to submit those plans to the Board as appropriate over the course of the year. The Board would then have some period of time following the submission to respond to the capital plan. This would permit subject companies to continue to manage their individual capital distribution planning process and would spread the regulatory burden for review of capital plan submissions. This approach would have no adverse affect on Board review of capital plans or the Board's ability to supervise these companies.

6. Informational Requests under the Proposed Rule

The Proposed Rule permits the Board to request a broad range of data from subject companies. It is unclear why the Board would require such submissions in connection with the capital plan process when much of the information requested has already been collected in other reports required for submission by the subject companies. The scope of the capital plan submission is overbroad and very burdensome as a result.

In addition, the Proposed Rule envisions the potential for submission of data as it relates to a specific date and on a loan level basis. Again the scope of the data request has the potential to

be overbroad and extremely burdensome without consideration of whether there exist sufficient regulatory need for such submission in connection with the capital plan review.

We recommend that any final rule clarify that any data submission should first require the Board to seek the information from other sources/formats in which the information has already been collected and that any information requested should be consistent with current regulatory reporting so as not to require significant additional system expenditure in order to comply.

Thank you for your consideration of our views. We are available for further discussion on this matter at your convenience.

Respectfully submitted,

Julie A. Spiezio

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