ACLI
Financial Security...for Life.

Julie A. Spiezio
Senior Vice President, Insurance Regulation & Deputy General Counsel
(202) 624-2194 t (866) 953-4083 f
juliespiezio@acli.com

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

Re: Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (FRS Docket No. 1438 & RIN 7100-AD-86)

Dear Chairman Bernanke:

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 on the Board's notice of proposed rulemaking implementing enhanced prudential standards and early remediation requirements for certain covered companies (the "Proposed Rules").[1]

I. Introduction

At the outset, we wish to reiterate our belief that the traditional core activities of life insurance companies do not present a systemic risk to the financial stability of the United States. As we have discussed in previous letters[2] to the Financial Stability Oversight Council (the "FSOC"), the traditional core activities of life insurers do not present a systemic risk for a number of reasons:

- The core business activity of most life insurers involves providing policyholder coverage for long-term risks, and matching these long-term, liabilities with assets appropriate to ensure that these liabilities can be met. This is a fundamentally different business model than other types of financial institutions which depend on short-term, on-demand funding, and are much more susceptible to runs on their liabilities during periods of stress.

- Core life insurance activities do not give rise to high interconnectedness with other financial institutions. Thus, life insurers do not exhibit the same levels of interconnectedness as banks.

- Life insurers are highly regulated in ways that decrease the risk they pose to the financial system. State insurance regulators have strict capital requirements, which operate not only to mandate a minimum capital buffer, but also to remove incentives to hold risky assets. Life insurers are also required to hold reserves against future losses based on prudent assumptions.

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1 Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 *Fed. Reg.* 594 (Jan. 5, 2012).

2 *See, e.g.*, Letter from the ACLI, to the Board (Dec. 19, 2011), *available at* http://www.acli.com/Newsroom/News%20Releases/Documents/ACLI_FSOC_121911.pdf.

- The insurance regulatory system provides an established process for the orderly rehabilitation or wind-down of impaired life insurers. This wind-down process, combined with the illiquid nature of insurance company liabilities, prevents "fire sale" liquidations that can spread contagion to otherwise healthy firms.

The findings of the International Association of insurance Supervisors (IAIS) in its recent paper, "Insurance and Financial Stability,"[3] also support the view that traditional insurance activities are unlikely to present systemic risks.

Other analyses have come to the conclusion that even if an insurer were to fail, the failure itself would be unlikely to cause systemic risk. For example, the Geneva Association recently published a detailed study of resolution experiences with insurance companies. Among the conclusions of the study are the following:

- The wind-down of an insurer has never caused a systemic financial crisis.

- The balance sheet of an insurer does not react to stresses in the same way as the banking balance sheet, because: (i) ongoing reserves stabilize the wind-down of the insurer; (ii) insurer reserves are held predominantly in local legal entities; and (iii) depending on local law, reserves are covered by assets specifically "tied" to those reserves.[4]

Taken together, these characteristics support the view that life insurers do not pose systemic risk. We urge the Board to remain cognizant of this view as it finalizes the Proposed Rules.

II. Required Tailoring for Nonbank Financial Companies

Our letter is prompted by an overriding concern that the Proposed Rules themselves do not appropriately distinguish between bank holding companies ("BHCs") that are subject to the Proposed Rules by virtue of the fact that they have at least $50 billion in total consolidated assets ("Large BHCs") and nonbank financial companies that are designated as systemically important under section 113 of the Dodd-Frank Act ("Nonbank Covered Companies"). This concern is informed by both the preamble to and the text of the Proposed Rules. In the preamble, the Board states that the Proposed Rules were "largely developed with large, complex [BHCs] in mind."[5] Although the Board notes in the preamble that following designation of a Nonbank Covered Company by the FSOC, the Board would "thoroughly assess the business model, capital structure, and risk profile of the designated company to determine how the enhanced prudential standards . . . should apply to the covered company" and that it "may, by order or regulation, tailor the application of the enhanced standards to designated nonbank financial companies on an individual basis or by category, as appropriate,"[6] nowhere in the Proposed Rules themselves does the Board draw an explicit distinction between Large BHCs and Nonbank Covered Companies. Instead, the Proposed Rules provide that both Large BHCs and Nonbank Covered Companies will be subject to the same set of enhanced standards.[7] This is in direct conflict with the provisions of section 165(b)(3), which require the Board to take into account differences among nonbank financial companies and BHCs and to adapt the required standards as appropriate to the predominant line of business of a nonbank financial company. The Proposed Rules do neither.

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3 IAIS, *Insurance and Financial Stability* (Nov. 2011), at 6, *available at* http://www.iaisweb.org/Otherpapers-and-reports-46.

4 *See* Geneva Association, *Insurance and Resolution in Light of the Systemic Risk Debate* (Feb. 2012), at 2-3, *available at* http://www.genevaassociation.org/PDF/BookandMonographs/GA2012-Insurance_and_Resolution_in_Light_of_the_Systemic_Risk_Debate.pdf.

5 *77 Fed. Reg. at* 597.

6 *Id.*

7 *Id.*

As we discuss in detail below, the failure of the Proposed Rules to distinguish explicitly between Large BHCs and Nonbank Covered Companies, and to provide explicitly for tailored application of the enhanced prudential standards and early remediation requirements based on these distinctions is not only inconsistent with the requirements of section 165(b)(3), but also would lead to an unworkable and ineffective set of requirements for Nonbank Covered Companies[8]. Such an outcome would be contrary to the interests of the Nonbank Covered Companies and the Board itself, but more importantly, it would be contrary to the purpose of section 165, which is to mitigate risks to the financial stability of the United States.

Accordingly, we submit that the Board must revise the Proposed Rules either to (i) provide specifically for the tailoring required by section 165(b)(3) *or* (ii) exclude Nonbank Covered Companies from the Proposed Rules and conduct a separate rulemaking to establish a process for tailoring the standards as required by section 165(b)(3) for Nonbank Covered Companies. As part of any such rulemaking process under section 165 for Nonbank Covered Companies, the Board should request recommendations from the FSOC under section 115 as to the appropriate tailoring of the standards to Nonbank Covered Companies. Any rules issued under section 165 for Nonbank Covered Companies must also provide for consultation (as required under section 165(b)(4)) by the Board with each of the FSOC members that primarily supervises any functionally regulated subsidiary of a Nonbank Covered Company prior to the imposition of prudential standards or other requirements on a Nonbank Covered Company. Any rules proposed by the Board for Nonbank Covered Companies should provide for an appropriate opportunity for Nonbank Covered Companies (none of which has yet been designated under section 113) to comment on the proposed rules as required by the Administrative Procedure Act. Any such proposed rules should also provide for an appropriate observation period before the rules become final, particularly if the Board decides to create prudential rules that differ from, or establish new requirements beyond, those imposed by the primary financial regulatory agency for the Nonbank Covered Company or for any functionally regulated subsidiary of the Nonbank Covered Company.

III. Coordination under Section 113 and Section 165

As both a legal and a policy matter the implementation of the section 165 prudential standards for Nonbank Covered Companies must be coordinated with the designation process under section 113. More specifically, there must be a tailoring of the standards applicable to Nonbank Covered Companies by the Board under section 165 based at a minimum on general recommendations from the FSOC under section 115. The preamble to the Proposed Rules appears to contemplate that there will be a tailoring of the prudential standards to Nonbank Covered Companies, but that the tailoring will only occur *after* the designation process under section 113 has been completed with respect to a specific nonbank financial company. The preamble states that after the designation of a company, the Board will "thoroughly assess the business model, capital structure, and risk profile of the designated company to determine how the enhanced prudential standards and early remediation requirements should apply."[9]

We submit that this thorough assessment of the business model, capital structure, and risk profile is necessarily part of the FSOC designation process itself and as a legal matter is the predicate for a designation determination. We agree with the Board's statement in the preamble to the Proposed Rules that the tailoring of the standards and requirements to different Nonbank Covered Companies on an individual basis or by category is important,[10] particularly because the types of business models, capital structures, and risk profiles could vary significantly. But we firmly believe that the FSOC designation process must be based upon the same thorough assessment of the business model, capital structure and risk profile of any company that would be subject to designation. The designation process itself necessarily involves two basic assessments: first, an assessment of the types of risks that a company

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8 One example of the inappropriateness of this "one-size-fits-all" approach as applied to a Nonbank Covered Company that is a life insurance company is illustrated by the Proposed Rules' suggestion that the word "debt" be defined as "total liabilities", discussed in greater detail *infra* at pg. 14.

9 *Id.*

10 *Id.*

may present that could result in a threat to U.S. financial stability and second, an assessment of how the enhanced standards in section 165 as applied to the particular company will mitigate those risks. To meet the purpose of section 113, it is incumbent upon the FSOC not only to determine that a company could pose a threat to U.S. financial stability, but also to determine how the application of the prudential standards in section 165 would mitigate the perceived threat.

This two-pronged assessment process will be particularly important when the FSOC is considering for designation a nonbank financial company that is already subject to comprehensive regulation by a primary financial regulatory agency such as a state insurance authority.[11] The FSOC itself has provided in its final rule and interpretive guidance for designating Nonbank Covered Companies that one of the overarching categories in its analytic framework for the designation process is the extent and scope of existing state or federal regulatory scrutiny, including detailed reporting requirements, capital and liquidity requirements, enforcement actions, and resolution authority.[12] The two-pronged assessment process is equally important when the FSOC is considering for designation a foreign nonbank financial company that also is already subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority.[13] As the FSOC itself provides in its notice of proposed rulemaking, the existence of an effective mechanism to resolve a nonbank financial company such as an insurance company will also be a factor in the designation process, and it will affect the type and extent of any additional prudential regulations that might be necessary under section 165. These considerations are directly relevant to any determination of the threat that an insurance company might pose to U.S. financial stability and to the type and extent of additional prudential regulation that might be thought necessary to address the threat.[14]

The FSOC assessment process, which must include these regulatory as well as all the other factors listed in section 113(a), provides the necessary basis for the FSOC to determine how the prudential standards should be applied to a Nonbank Covered Company and to make recommendations to the Board as envisioned by section 115. Section 115(a)(2) envisions that the FSOC may make recommendations to the Board on differentiating among companies on an individual basis or by category. Section 115(b)(3) envisions that the FSOC in making recommendations will take into account differences among nonbank financial companies and BHCs based *inter alia* on the factors listed in section 113(a) and will adapt its recommendations as appropriate in light of the predominant line of business of the company. Reinforcing the thrust of these provisions in section 115 is section 113(g), which requires the FSOC to consult with the primary financial regulatory agency for each nonbank financial company or subsidiary of a nonbank financial company before any final designation determination is made with respect to the company. The in-depth assessment and consultation process required by section 113 provides the natural basis for the recommendations envisioned by section 115(b)(3), the language of which parallels the language in the tailoring provisions in section 165(b)(3) itself.[15] Although the FSOC has said in the preamble to its final rule on the designation of nonbank financial companies that it "does not generally intend to make company-specific regulatory recommendations to the Board,"[16] we submit that the Board should request recommendations from the FSOC on how the prudential standards provided in section

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[11] Section 113(a)(2) requires the FSOC to consider a list of considerations, including the degree to which a company is already regulated by one or more primary financial regulatory agencies. Section 2 of the Dodd-Frank Act defines "primary financial regulatory agency" to include a State insurance authority of the State in which an insurance company is domiciled with respect to the insurance activities and activities that are incidental to such insurance activities of an insurance company that is subject to supervision by the State insurance authority under State insurance law.

[12] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 *Fed. Reg.* at 21637.

[13] *See* Pub. L. No. 111-203, § 113(b)(2)(H) (codified at 12 U.S.C. § 5323(b)(2)(H)).

[14] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 *Fed. Reg.* 64264, 64282 (Oct. 18, 2011).

[15] Coordination also ensures that the Board will receive the active advice and input on the appropriate treatment of insurance entities from the three FSOC members with insurance expertise.

[16] *See* 77 *Fed. Reg.* at 21647.

165 should be applied to the designated company to mitigate the risks identified by the FSOC in its designation process. It is likewise incumbent on the FSOC to provide recommendations to the Board on how the prudential standards in section 165 should be applied to a Nonbank Covered Company to mitigate the threats that the FSOC itself has identified in the designation process with respect to that company.

IV. Application to Savings and Loan Holding Companies

As the Board itself indicates in the preamble, with the exception of section 165(i)(2), sections 165 and 166 do not apply to savings and loan holding companies (SLHCs). Nevertheless, the Board indicates in the preamble that it intends to apply the enhanced standards to certain SLHCs to "ensure their safety and soundness."[17] The Board indicates its intent to issue a separate proposal for notice and comment to initially apply the enhanced standards and early remediation requirements to all SLHCs with "substantial banking activities," *i.e.* any SLHC that (i) has total consolidated assets of $50 billion or more, and (ii) that (A) has savings association subsidiaries which comprise 25 percent or more of the SLHC's total consolidated assets, or (B) controls one or more savings associations with total consolidated assets of $50 billion or more.[18] The Board indicates that it will not issue such a proposal until such time as it has established risk-based capital requirements for SLHCs.

We respectfully disagree with the suggestion that the Board may extend the proposed section 165 and section 166 requirements to SLHCs with "substantial banking activities." Section 165 and section 166 clearly provide that the enhanced standards and early remediation requirements apply only to Large BHCs and Nonbank Covered Companies and not to SLHCs as such. Section 165(i)(2) specifically enumerates the one instance in which an enhanced standard applies to SLHCs. In seeking to apply the entire of enhanced standards to certain SLHCs, the Board obviates this carefully crafted statutory scheme. Nor does the Home Owners' Loan Act as amended by the Dodd-Frank Act authorize the Board to impose Title I standards on SLHCs. By conflating two distinct statutory schemes, the Board contradicts Congress's clear and deliberate intent to only apply one of the Title I requirements (namely, section 165(i)(2)) to SLHCs, rather than the enhanced prudential framework as a whole.

By proposing to apply the Title I enhanced standards and early remediation requirements to certain SLHCs, the Board has effectively made a determination expressly reserved for the FSOC. This determination is at odds with Congressional intent and the plain language of Title I itself. This determination also flies in the face of the Board's previous statement that it would develop a regulatory and supervisory framework for SLHCs that "to the greatest extent possible [takes] into account [the] unique characteristics of SLHCs and the requirements of the Home Owners' Loan Act."[19] We request that the Board remain cognizant of this statutory framework and of its prior previous statements, and refrain from applying sections 165 and 166 to SLHCs.

V. Phase-In

In addition to the need to tailor the prudential standards to Nonbank Covered Companies, it is essential that the Board provide for a phase-in period for the enhanced standards that recognizes the fundamentally different posture between Large BHCs that are already subject to comprehensive regulation by the Board and Nonbank Covered Companies that will become subject to such regulation for the first time upon their designation. For example, the proposed capital and leverage requirement would become applicable to a Nonbank Covered Company 180 days after designation and the stress testing requirement would become applicable to a Nonbank Covered Company in the same calendar year it is designated by the FSOC if the date of designation is more than 180 days before September 30. A Nonbank Covered Company that is designated before September 30, 2012 will become subject to the

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[17] 77 *Fed. Reg.* at 598.

[18] *Id.*

[19] Board, Supervision and Regulation Letter 11-11: Supervision of Savings and Loan Holding Companies 2 (July 21, 2011), *available at* http://www.federalreserve.gov/boarddocs/srletters/2011/sr1111.htm.

single-counterparty exposure limit beginning October 1, 2013. The other enhanced prudential requirements would become effective five calendar quarters after the Nonbank Covered Company is designated. These phase-in periods are highly unrealistic for companies that do not have the pre-existing risk infrastructure and management information systems ("MIS systems") designed around the bank-centric requirements of the Proposed Rules. Moreover, the substantive standards such as capital will require more extended phase-in periods.

We submit that the Proposed Rules should be revised to provide for an appropriate phase-in period for Nonbank Covered Companies. As a general matter, it is clear that both Large BHCs and Nonbank Covered Companies will be required to make significant investments in risk infrastructure and MIS systems to bring themselves into compliance with the Proposed Rules. However, Nonbank Covered Companies will be required to undertake much more significant investments in risk infrastructure and MIS systems than Large BHCs. Much of the enhanced prudential requirements in the Proposed Rules represent enhancements to existing bank prudential requirements. Although Large BHCs will still need to make significant investments to bring their risk infrastructure and MIS systems into compliance with the enhanced standards under the Proposed Rules, Large BHCs already have existing infrastructure and MIS systems that are generally designed around such requirements. Nonbank financial companies have developed risk infrastructure and MIS systems based on their own specific mix of financial activities (principally nondepository activities) and on applicable regulatory requirements such as state insurance law requirements. These infrastructure and MIS systems differ substantially from those applicable to a financial institution with a dominant depository institution, such as a Large BHC. As a result, a Nonbank Covered Company will either have to develop entirely new risk infrastructure and MIS systems or graft a risk and technology infrastructure designed for a large banking organization onto its existing framework. In either case, a Nonbank Covered Company will face significantly greater challenges than a Large BHC in meeting the requirements of the Proposed Rules.

In requesting an appropriate phase-in period for Nonbank Covered Companies, we also note that Nonbank Covered Companies will not have the benefit of having been subject to Board regulation and supervision for many years, unlike Large BHCs. An established supervisory relationship means that Large BHCs are more familiar with the Board's expectations than Nonbank Covered Companies as it relates to supervision generally and as it relates to implementation of the Proposed Rules. Greater familiarity with Board supervision will translate to greater ease of compliance with the Proposed Rules. It would be inappropriate to expect a Nonbank Covered Company to exhibit the same familiarity with Board supervisory approaches and techniques as a Large BHC, and as such it would be inappropriate to expect a Nonbank Covered Company to bring itself into compliance with the Proposed Rules within the same timeframe as a Large BHC.

In light of these concerns, we request that the Proposed Rules be amended to provide for an appropriate phase-in period for Nonbank Covered Companies, one that provides Nonbank Covered Companies with sufficient time to make investments in and implement the necessary risk infrastructure and MIS systems to bring themselves into compliance with the enhanced prudential standards and early remediation requirements. In this regard we note by analogy that the Basel Committee has provided for a "lengthy transition period" for the enhanced capital standards under Basel III, including in particular for the new leverage ratio.[20] We also note that the Basel III framework provides for multi-year observation periods prior to full implementation of its two new liquidity ratios, the Liquidity Coverage Ratio and the Net Stable Funding Ratio. These multi-year observation periods, which the Basel Committee instituted to mitigate any potential "unintended consequences"[21] associated with implementation of the new liquidity ratios, illustrates the importance of observation, testing and calibration when requiring financial institutions to adhere to a new or enhanced prudential regulatory regime. We submit that the Board should take an

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20 *See, e.g.,* Jaime Caruna, General Manager, Bank for International Settlements, *Remarks at the 2012 ADB Financial Sector Forum on "Enhancing financial stability – issues and challenges"* (Feb. 7, 2012), *available at* http://www.bis.org/speeches/sp120208.htm?ql=1.

21 **See Basel III: International framework for liquidity risk measurement, standards and monitoring (Dec. 2010), *available at* http://www.bis.org/publ/bcbs188.htm.**

analogous approach as the Basel Committee when applying the enhanced standards to Nonbank Covered Companies, which are themselves a new prudential regulatory regime as applied in such a context. Such an approach should also include an observation period to assess the potential effects of any new regime.

We offer specific comments on the Proposed Rules below.

VI. Enhanced Prudential Standards

A. Capital and Leverage

The Proposed Rules would require a Nonbank Covered Company to comply with three capital standards potentially as early as 180 days after being designated by the FSOC. First, the Proposed Rules would require a Nonbank Covered Company to calculate minimum risk-based capital and leverage requirements as if it were a BHC, in accordance with any minimum capital requirements established by the Board for BHCs. Second, the Proposed Rules would require a Nonbank Covered Company to hold capital sufficient to meet: (i) a tier 1 risk-based capital ratio of 4 percent and a total risk-based capital ratio of 8 percent, as calculated according to the general risk-based capital rules; and (ii) a tier 1 leverage ratio of 4 percent as calculated under the leverage rule. Third, the Proposed Rules would require a Nonbank Covered Company to comply with, and hold capital commensurate with, the requirements of regulations adopted by the Board relating to capital plans and stress tests as if the Nonbank Covered Company were a BHC, including the Board's recently finalized rule on capital plans.[22] The Board's final capital plan rule in effect imposes an additional minimum capital requirement of tier 1 common risk-based capital of 5% under expected and stressed conditions over a minimum nine-quarter planning horizon.

Requiring a Nonbank Covered Company to comply with enhanced capital standards designed for BHCs as early as 180 days after being designated would be inappropriate, both because of the uncertainty surrounding capital-related reforms and because of the conceptual and practical difficulties associated with imposing a bank-centric capital framework on a nonbank financial company in such an abbreviated timeframe. With respect to the concern about uncertainty, we note that two critically important rulemakings relating to capital have yet to be completed. The Board and the other Federal banking agencies have yet to promulgate rules implementing the Basel III capital framework, and the Board has yet to establish risk-based capital requirements for SLHCs. Grandfathered unitary SLHCs share several common elements with the potential nonbank financial companies to be designated under section 113. Among the shared elements is the prevalence of diverse business models, including models that are heavily weighted toward nondepository financial activities including insurance where the Board has had less direct supervisory experience. Another shared element is the existence of other comprehensive regulatory regimes specifically designed by regulators with longstanding responsibility and experience in financial activities such as insurance. Of particular note is the insurance risk-based capital regime implemented by the states and utilizing formulas developed and modified by the National Association of Insurance Commissioners (the "NAIC").

Because these rulemakings are of critical importance, we submit that the Proposed Rules should not apply to Nonbank Covered Companies until these two rulemakings have been promulgated and finalized. This will provide nonbank financial companies potentially subject to designation by the FSOC with much-needed certainty as to the nature of the enhanced capital standard they face, and will also reduce the potential for significant problems which could otherwise arise if the Board requires Nonbank Covered Companies to adhere to a capital frameworks designed for BHCs. It will also provide an important opportunity to develop the tailored approach to the implementation of section 165 which is required by the terms of section 165 for nonbank financial companies.

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22 Capital Plans, 76 *Fed. Reg. at* 74631 (Dec. 1, 2011).

More fundamentally, we believe that any capital framework applicable to Nonbank Covered Companies must recognize the fundamental differences between life insurance companies and banking organizations to avoid the significant conceptual and practical problems that would arise from the imposition of a capital framework specifically designed for banking entities on insurance entities. As we have discussed on previous occasions, the Board's current capital rules, as well as its approach to capital regulation in general, do not account for these fundamental differences.[23] For instance, the BHC rules do not sufficiently account for insurance-related assets, nor do they sufficiently account for instances where a company engages in other nondepository activities. Nor do the BHC rules appropriately account for the unique nature of various life insurer products.[24] Similarly, the risk-based capital formulas provide no weightings for insurance risks, such as exposure to mortality losses or fluctuations in claims reserves. As noted in a 2002 joint report of the staff of the Board and the NAIC, the different capital approaches for insurance companies and banks reflect the "inherent differences between the insurance and banking industries."[25] 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."[26] Rather, 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."[27] The fundamental differences between the insurance industry and the banking industry must be taken into account by the Board as it designs risk-based capital and leverage requirements for any insurance company that might be designated by the FSOC.

Because of these differences, any attempt by the Board to apply the BHC capital framework to a Nonbank Covered Company predominantly engaged in insurance activities would give rise to myriad practical problems related to implementation, and would lead to Nonbank Covered Companies reporting capital ratios to the Board which provide inaccurate or misleading information about the Company's overall risk profile. These problems will no doubt be exacerbated if the Nonbank Covered Company has only 180 days after being designated to design and implement the necessary systems to calculate and report risk-based capital ratios on a consolidated basis. In sum, requiring a Nonbank Covered Company to adhere to the BHC capital and leverage rules would do little to achieve the underlying objectives of an enhanced prudential framework, and would run the risk of providing inaccurate or irrelevant information to the regulators and to the market about a Nonbank Covered Company.

B. <u>Liquidity</u>

The Proposed Rules would require a Nonbank Covered Company to implement substantial and extensive policies and procedures relating to liquidity risk management, including extensive liquidity stress testing, the creation and maintenance of cash flow projections, and the establishment and maintenance of a contingency funding plan. The Proposed Rules would also require significant involvement of a Nonbank Covered Company's board of directors in the liquidity risk management process by, for example,

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23 *See*, 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 Board (Feb. 25, 2011), *supra* note 2.

24 One example can be seen in the treatment of variable separate accounts. That base product's inherent risks come from fluctuations in interest rates, equity markets, etc., and the resulting changes in fund performance are borne by policyholders as reflected in the account value change. In some instances policyholders can purchase guarantees that transfer a portion of the risks to the company's general account, and separate reserves are held by the insurance company in the general account for these guarantees. As a result, these separate account assets need to be treated quite differently from the general account assets of life insurance companies.

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

26 *Id*.

27 *Id*. at 3.

requiring a Nonbank Covered Company's board of directors to oversee the Company's liquidity risk management processes and review and approve the liquidity risk management strategies, policies and procedures established by senior management of the Company.

Because the liquidity requirements seem premised on the assumption that the Nonbank Covered Company will have the liquidity profile of a Large BHC, they suffer from the same flaw as the provisions of the Proposed Rules relating to enhanced capital and leverage requirements, in that there is no allowance for the differences between Nonbank Covered Companies and Large BHCs.

This distinction is particularly significant when comparing life insurance companies to Large BHCs. As we have discussed above, there are several fundamental characteristics of life insurers that should be taken into account when developing a liquidity risk management policy that could potentially apply to these companies. Most importantly, life insurers have a much different mix of liabilities on their balance sheets than traditional banking organizations, in that life insurer liabilities are predominantly long-dated (as in the case of a life insurance policy), rather than short-dated (as in the case of a bank deposit). It is unlikely that a life insurer will be subject to a "liquidity" problem arising from a lack of short-term funding. Indeed, the insurance industry as a whole provided significant funding stability to the financial sector during the recent financial crisis.[28]

Liquidity risk management by life insurers is therefore appropriately informed by the fact that the risk of a short-term liquidity squeeze is low. It would thus be inappropriate to apply the provisions of the Proposed Rules relating to liquidity risk management in their current form to a life insurer, as these provisions presuppose that the Nonbank Covered Company is likely to face a shortfall in short-term funding. Provisions relating to liquidity risk management inapposite to life insurers include:

- The Proposed Rules would require a Nonbank Covered Company to evaluate the liquidity costs, benefits, and risks of each significant new product.

- The Proposed Rules would require a Nonbank Covered Company to undertake annual reviews of the liquidity risk implications of existing significant business lines and products, regardless of whether review was necessary in light of the "material" liquidity risks with respect to significant business lines and products that the Nonbank Covered Company actually faced.

- The Proposed Rules would require the Nonbank Covered Company to conduct monthly liquidity stress tests, quarterly reviews and approvals of cash flow projections, and review liquidity practices, methodologies, assumptions and liquidity stress test results, regardless of whether such analyses are relevant to the risks that are actually material to the Nonbank Covered Company's business model.

- The Proposed Rules would require a Nonbank Covered Company to project comprehensive cash flows on a daily and monthly basis, when for Nonbank Covered Companies with predominantly insurance operations, cash flow analysis focuses on ensuring that long-term cash flows arising from insurance company investment holdings (such as long-dated corporate bonds) are appropriately matched with the Company's long-term liabilities.

As a general matter, there are substantial differences between bank liabilities and life insurance liabilities. Bank account balances can be withdrawn at any time with no or only relatively minor penalty so there is little disincentive for a customer to withdraw and redeposit the account balance with another bank. By comparison, life insurance liabilities and annuities are subject to substantial disincentives for a customer to withdraw her policy account value or annuity. Here are some important examples:

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[28] *See* Paul J. Davies, *Banks Eye Insurers for Funding Stability*, FIN. TIMES, Apr. 9, 2012, http://www.ft.com/intl/cms/s/0/b08970f2-7a5a-11e1-9c77-00144feab49a.html#axzz1rdsf5as7 (noting that "banks are now looking to insurance-type businesses as a potential source of very long-term and stable funding").

- Surrender Charges. Most deferred annuity contracts include a surrender charge as a contract feature. A surrender charge is a direct deduction the insurer makes against the account balance if the policyowner makes a full or partial withdrawal of the account balance. Given the long-term nature of these contracts, this charge is specifically designed to take into account the effect of an early withdrawal on the long-term matching of assets to liabilities that occur at contract issuance.

- Insurability. Persons who have been insured under a life insurance policy for some years may have since declined in health and may either not be eligible for replacement life insurance from another insurer or would be required to pay a substantial increased cost for replacement life insurance. Thus, the insurability of the insured life acts as a disincentive to policy replacement activity. It may be more cost effective for an insured person to retain her original life insurance than seek to replace it.

- Ongoing Premium Payments. Many life insurance policies require payment of a periodic premium. Failure to pay the premium results in a lapse and termination of coverage (e.g., the life insurer is no longer obligated to pay a death claim). Coupled with changes in insurability, there is a substantial incentive for a policyowner to continue to pay periodic premiums. Causing a policy to lapse results only in a modest nonforfeiture benefit under a whole life insurance policy but complete forfeiture of previously paid premiums under a term life insurance policy.

- Tax Implications. Termination of a life insurance policy or annuity contract (particularly a variable insurance policy or contract) may result in a tax event on the withdrawal value if the assets supporting the policy have performed well. This acts as a disincentive to such a withdrawal in that the policyowner may not wish to pay taxes on the gain under the policy. Taxes on the gain are otherwise deferred so long as the policy remains in effect.

In sum, the provisions of the Proposed Rules relating to liquidity and liquidity risk management are based on the incorrect assumption that a Nonbank Covered Company faces the same set of liquidity risks as a Large BHC. In so assuming, the Proposed Rules make no explicit provision for tailoring the liquidity and liquidity risk management requirements to the scale and nature of the liquidity risks that Nonbank Covered Companies such as insurance companies actually face. We request that the final rules explicitly provide for tailoring of the liquidity and liquidity risk management requirements based on the actual risks faced by a Nonbank Covered Company and provide the appropriate flexibility for a Nonbank Covered Company to design its liquidity risk management program based on its specific business model and products.

C. Single-Counterparty Exposure Limit

As is the case with the other provisions of the Proposed Rules, it is our belief that the provisions of the Proposed Rules relating to the single-counterparty exposure limit are ill-suited to the structures and activity mixes of Nonbank Covered Companies.

Under the Proposed Rules, a Nonbank Covered Company, together with its subsidiaries, would be prohibited from having aggregate net credit exposure to any unaffiliated counterparty which exceeded 25 percent of the consolidated capital stock and surplus of the Nonbank Covered Company. The Proposed Rules define "capital stock and surplus" to include, *inter alia*, the balance of the company's allowance for loan and lease losses not included in tier 2 capital under the capital adequacy guidelines applicable to the Nonbank Covered Company. In addition, the Proposed Rules impose a more stringent single-counterparty exposure limit on "major" covered companies, which would include Large BHCs with total assets greater than or equal to $500 billion and all Nonbank Covered Companies.

Complying with the single-counterparty exposure limit will require a Nonbank Covered Company to engage in data aggregation efforts that far exceed any existing requirements or systems that Nonbank

Covered Companies currently have in place. The requirements of the Proposed Rules will present significant challenges for Large BHCs, but even greater challenges for Nonbank Covered Companies. These challenges will be compounded by the broad definition of "control" in the Proposed Rules. Based on the definition of "control" in the Proposed Rules, Nonbank Covered Companies may be unable to access and aggregate counterparty information required to determine which counterparties are subsidiaries of other counterparties. From the perspective of a Nonbank Covered Company itself, even if the Nonbank Covered Company would theoretically have the ability to determine which of its investments in other companies meet the proposed broad definition of "control," the Nonbank Covered Company would in many cases (especially in the case of minority equity investments in third party investee companies) be unable to monitor and track the exposures of the investee company. As a practical matter, it will be difficult, if not impossible, for Nonbank Covered Companies to monitor and aggregate the exposures of entities in which they are passive investors. In addition, they may not have the ability to control exposures of the investee company. We submit that the definition of "control" should be amended to only include companies that are required to be consolidated for financial reporting purposes.

We also believe it is inappropriate for the Board to deem every Nonbank Covered Company, regardless of its size or interconnectedness, to be a "major" covered company, thus subjecting it to the more stringent single-counterparty exposure limit. To subject all Nonbank Covered Companies to the more stringent limit would be to ignore the significant differences in size and interconnectedness between Nonbank Covered Companies and Large BHCs and the significant variations in size and interconnectedness between and among the various Nonbank Covered Companies themselves. Given that the more stringent exposure limit for major covered companies is presumably motivated by the view that interconnectedness among large financial institutions should be reduced, the failure to draw any distinction between a "major" covered company that is a Large BHC and Nonbank Covered Companies is puzzling in light of the fact that there is major interconnectedness in the interbank market that does not exist in the insurance market.

In recognition of the distinct differences in the levels of interconnectedness between Nonbank Covered Companies as compared to banks, we submit that the Board should not require that all Nonbank Covered Companies be subject to the more stringent single-counterparty exposure limit. Instead, we request that the Board amend the final rules to explicitly provide that when contemplating imposing the more stringent limit on a Nonbank Covered Company, the Board must take into account the actual level of interconnectedness in the predominant business line of the Nonbank Covered Company.

Furthermore, as currently drafted several provisions of the Proposed Rules relating to the single-counterparty exposure limit are essentially bank-centric in focus. The inclusion of allowances for loan and lease losses in the definition of "capital stock and surplus" stands as an example of the inclusion of an essentially bank-centric provision in rules that are proposed to be applied to Nonbank Covered Companies. The Board should tailor the single-counterparty exposure limit for Nonbank Covered Companies to ensure that it does not rely on essentially bank-centric provisions. By tailoring the limit to the actual activity profile of Nonbank Covered Companies, the Board will ensure appropriate treatment for Nonbank Covered Companies.

We note that the Board has also inquired in the preamble to the Proposed Rules whether the definition of "subsidiary" should be expanded to include "any investment fund or vehicle advised or sponsored by a covered company or any other entity."[29] We strongly believe that the definition of "subsidiary" should not be expanded in this manner for Nonbank Covered Companies. To expand the definition in this manner would be to disregard the legal and operational separateness of funds from their advisors and sponsors. The existing legal, regulatory and business structures of Nonbank Covered Companies would be unable to accommodate such an expansion, as the legal and operational separateness of advised and sponsored funds means that various funds advised or sponsored by the same entity do not currently

[29] 77 *Fed. Reg.* at 615.

engage in aggregate data collection with respect to counterparty exposure. In addition, funds and their advisers must adhere to strict fiduciary duties by putting the interests of the individual funds' ahead of their own interests and, with respect to each fund, ahead of the interests of other funds'. Artificial limits on counterparty exposure would not properly account for this fiduciary duty. Furthermore, expanding the definition of subsidiary to include sponsored or advised funds would produce a distorted view of counterparty exposure and likely lower inappropriately the effective limit for Nonbank Covered Companies engaged in asset management activities.

Finally, we believe the Board should exempt (i) direct exposures to the United States and its agencies, regardless of whether they are guaranteed as to principal and interest; (ii) direct exposures to U.S. States and their political subdivisions and (iii) direct exposures to foreign governments that are members of the Organization for Economic Cooperation and Development from the single-counterparty exposure limit. These exemptions are comparable to the exemptions provided for in section 252.97 of the Proposed Rules, and should be added as additional categories of exempted exposures. As is the case for the exposure categories already exempted under the Proposed Rules, there is a significant policy interest in exempting these categories of exposures from the limit.

D. Risk Management, Risk Committee and Chief Risk Officer

As is the case with the provisions of the Proposed Rule relating to liquidity risk management, the provisions of the Proposed Rules relating to risk management in general presuppose that a Nonbank Covered Company is similar in risk profile and has a similar risk management framework to a Large BHC. This assumption fails to recognize that Nonbank Covered Companies face different risks than Large BHCs and have developed risk management frameworks that are appropriately tailored to these different risks.

It is imperative to recognize that the risks facing life insurers are in many ways completely distinct from the risks facing large banking organizations. First, life insurers face risks that are almost wholly uncorrelated with the risks arising from traditional banking activities, such as lending and deposit-taking. As the IAIS notes, "The [insurance] business model exposes insurers to unique risks [] which are not typically found in banking. Unique [risks] in insurance underwriting [include] . . . mortality, morbidity, property and liability risks."[30] Mortality risk, for instance, is almost wholly uncorrelated with the risks arising from defaults on extensions of credit, trading book losses, or runs on deposit liabilities. Second, life insurers typically face risks which exhibit a lower level of *intra-correlation* than risks facing banking organizations, meaning that liability- and asset-specific risks facing life insurers exhibit less correlation than asset- and liability- risks facing banking organizations. Indeed, the "traditional business model of insurance builds on the underwriting of *largely diversified pools of mostly idiosyncratic and uncorrelated risks*."[31] For example, during periods of market stress, the different types of and asset and liability-risks facing a banking organization, such as risks arising from defaults on extensions of credit, trading book losses or runs on deposit liabilities, are likely to be significantly correlated and are likely to be interconnected through positive feedback loops. Thus, increased loan or trading losses would increase the probability that the banking organization would suffer a run on its deposit or wholesale funding liabilities. By contrast, life insurer liability risks (such as increased mortality risk resulting from a natural disaster) are less likely to be correlated with risks which impact the value of the insurer's assets, such as a change in interest rates which causes issuers to default on debt obligations held by the insurer.

[30] *Insurance and Financial Stability, supra* note 3, at 3. The findings in the IAIS paper on the differences between the insurance and banking business models also parallel findings in a recent report prepared by a Working Group established by the Committee on the Global Financial System under the auspices of the Bank for International Settlements. *See* Committee on the Global Financial System, CGFS Paper No. 44, *Fixed income strategies of insurance companies and pension funds* 9 (July 2011), available at http://www.bis.org/publ/cgfs44.pdf.

[31] *Id.* at 6 (emphasis added).

Given the significant differences in the correlation of risks facing life insurers and banking organizations, it is puzzling that the provisions of the Proposed Rules relating to risk management presuppose that a Nonbank Covered Company takes the same approach to risk management as a Large BHC. For instance, the Proposed Rules make no provision for the fact that because a Nonbank Covered Company faces risks that are less likely to be correlated, it will design its risk management framework to reflect this fact. In other words, the design of an enterprise-wide risk management framework should be a function of the probability that the enterprise itself faces correlated risks across the various activities conducted by the organization. Instead of providing that a Nonbank Covered Company's risk management framework will be tailored to its actual risk profile, the Proposed Rules simply assume that a consolidated, enterprise-wide approach to risk management is best for the Nonbank Covered Company. We submit that this assumption must itself be examined to determine whether an enterprise-wide risk management framework is in fact appropriate for a Nonbank Covered Company which faces uncorrelated risks across its various activities, activities which differ significantly from traditional banking and trading activities.

As a separate matter, it is also important to note that the provisions of the Proposed Rules relating to both liquidity risk management and risk management in general would impose responsibilities on Nonbank Covered Company boards of directors that have traditionally been within the purview of company management. This risk is especially high for life insurers, because the unique nature of insurance risk management requires that insurance company boards of directors establish foundational principles for an insurer's risk management framework, with management having responsibility for implementing these principles. There is also a concern that the Proposed Rules could be read to require that each member of a Nonbank Covered Company's risk committee have significant experience developing and applying risk management practices and procedures. This requirement is at odds with empirical realities concerning the structuring of Nonbank Covered Company risk committees and the availability of trained and experienced personnel to serve on these risk committees.

We also note that section 165(h)(1) provides that the Board must require each Nonbank Covered Company "that is a publicly traded company" to establish a risk committee. The Dodd-Frank Act thus draws an explicit distinction as to the risk committee requirement between Nonbank Covered Companies that are publicly traded and Nonbank Covered Companies that are not. The Proposed Rules, however, draw no such distinction with respect to Nonbank Covered Companies, and require any Nonbank Covered Company to establish a risk committee regardless of whether it is publicly traded or not. The Board provides no explanation for why the Proposed Rules fail to mirror this clear statutory distinction.

We thus submit that the Board should not seek to define a required risk management framework for Nonbank Covered Companies *ex ante*, and should instead assess whether the specific structure and activity mix of a Nonbank Covered Company necessitate changes to its existing risk management framework. If so, the Board should tailor the enhanced risk management requirements to the particular risks that the Nonbank Covered Company faces, including, where appropriate, allowing the Nonbank Covered Company to combine its risk and finance committees as a way to ensure strong oversight of capital, liquidity and stress testing.

E. <u>Stress Testing</u>

The Proposed Rules contemplate that a Nonbank Covered Company would be subject to a stress testing regime based almost entirely on the Board's experiences with stress testing of Large BHCs. Indeed, the Board prefaces its discussion of the stress testing requirements by referring to the stress testing exercises which it conducted for Large BHCs in the wake of the financial crisis, the Supervisory Capital Assessment Program and the Comprehensive Capital Analysis and Review. As is the case with the other provisions of the Proposed Rules, we believe that the Board should explicitly tailor the stress testing requirements in the Proposed Rules in recognition of the differences between Large BHCs and Nonbank

Covered Companies. In this regard, we have several concerns with the stress testing requirements as they would apply to Nonbank Covered Companies.

First, the baseline, adverse, and severely adverse economic scenarios contemplated by the stress testing regime fail to account for the different types of risks that Nonbank Covered Companies face. As discussed above, insurance companies face risks that are in many instances unique to their business model. To account for these unique risks, any stress testing regime for a Nonbank Covered Company should incorporate shocks relating to the exogenous factors that actually impact the Nonbank Covered Company, such as a shock to an insurance company's insurance policy portfolio arising from a natural disaster. Any stress testing scenarios for Nonbank Covered Companies should similarly de-emphasize shocks arising from traditional banking activities, as risks arising from traditional banking activities such as commercial and consumer lending are likely to be of comparatively less importance to these companies.

Second, the provisions of the Proposed Rules relating to required data and information for stress testing are almost entirely bank-centric in content. For instance, under the Proposed Rules a Nonbank Covered Company could potentially be required to provide information so that the Board could derive robust projections of the company's pre-provision net revenue and allowance for loan losses, a metric that, as discussed, is of great relevance to banking organizations but of little relevance to a life insurer. The requirement that the Nonbank Covered Company provide the Board with information on exposures in the Company's trading portfolio seems similarly bank-centric, as life insurers do not engage in significant trading activities as compared to a Large BHC. The specific data and information required for stress testing should be tailored to the Nonbank Covered Company which actually conducts the stress tests. For example, stress tests related to variable insurance products need to be tailored to capture long-term stress impact and the results thereof.

Third, concerns with compliance and phase-in are particularly acute in the context of the stress testing requirement, as a Nonbank Covered Company could potentially be subject to the supervisory stress testing requirement only 180 days after it is designated by the FSOC. We question the efficacy and utility of subjecting a Nonbank Covered Company to a bank-centric stress testing framework only six months after it is designated as systemically important, a framework that could be based on largely irrelevant data and yield confusing and misleading results.

Finally, we wish to raise the concern that public disclosure of a Nonbank Covered Company's stress test results could create additional problems that may not arise in the context of disclosure of a Large BHC's stress test results. The marketplace has familiarity with and thus will be better able to interpret a Large BHC's stress test results. By contrast, it is unclear whether disclosure of a Nonbank Covered Company's stress test results could provide the marketplace with useful information concerning the Company's overall risk profile. The Board should be cautious in assuming that public disclosure of a Nonbank Covered Company's stress test results will provide the same benefit as public disclosure of a Large BHC's stress test results.

F. Debt-to-Equity Limit

Section 165(j) provides that the Board shall require a covered company to maintain a debt-to-equity ratio of no more than 15-to-1 upon a determination by the FSOC that the company poses a grave threat to the financial stability of the United States and that the imposition of such a requirement is necessary to mitigate the risk that the company poses to the financial stability of the United States. Section 165(j) is intended as an extraordinary measure, which would be invoked only if the FSOC makes a finding that a particular covered company poses a grave threat to the financial stability of the United States. In making this finding, the FSOC is directed to consider the factors listed in subsections (a) and (b) of section 113.

We note that the Proposed Rules materially deviate from the language of section 165(j) by defining the word "debt" to mean "total liabilities." We submit that the substitution of the phrase "total liabilities" for the phrase "debt" is not supported by the language of section 165(j) and fails to take account of the differences between the liability structures of Nonbank Covered Companies and Large BHCs.

In the case of a Nonbank Covered Company that is an insurer, it would be particularly inappropriate and misleading to define "debt" to mean the "total liabilities." Insurers have different types of liabilities and account for liabilities in a significantly different manner than BHCs. Under applicable accounting principles, insurers must account for future liabilities arising from underwritten insurance policies and hold reserves in anticipation of those future liabilities. Reserves for future insurance policy liabilities understandably represent a significant part of the total liabilities of an insurer and are not comparable in kind or relative size to the reserves held by banking entities. Likewise, many life insurers maintain significant separate account balances, reflected as assets and offsetting liabilities on their balance sheets. The separate account category is unique to insurers and is not comparable to any category of asset or liability for a banking entity. Whatever conceivable arguments might be made for implementing section 165(j) by using total liabilities of a banking entity as a proxy for debt (and we note even as to banking entities that the phrase used in the statute is "debt" and not "total liabilities"), it is clear that the substitution of the phrase "total liabilities" for "debt" in the application to insurance companies is not justified and reflects a failure to take account of the fundamental differences between life insurers and banking entities. We request that the Board in a separate rulemaking tailor the proposed rules for the debt-to-equity ratio to take into account differences among nonbank financial companies and banking entities and the predominant line of business of the nonbank financial company. We specifically submit that the substitution of "total liabilities" for the statutory term "debt" is inappropriate and unauthorized as applied to any insurer.

VII. Early Remediation Requirements

The Proposed Rules contemplate an early remediation framework which expands the prompt corrective action ("PCA") rules currently applicable to insured depository institutions under the Federal Deposit Insurance Act. Because the early remediation requirements are based on the PCA framework, the early remediation triggers are by and large bank-centric in focus and hence suffer from the same kinds of defects that affect the other proposed standards.

Most obviously, the remediation triggering events that are triggered by risk-based capital and leverage ratio tests based on the Board's risk-based capital and leverage rules for BHCs share the same flaws as the provisions in the Proposed Rules (as discussed above) that would impose such capital and leverage requirements directly on Nonbank Covered Companies. The Proposed Rules for early remediation simply impose the same bank-centric rules on Nonbank Covered Companies indirectly. Similarly, the remediation triggering events based on the bank-centric liquidity and risk management provisions in the Proposed Rules share the similar defect of embedding these standards into the early remediation regime. Any early remediation trigger for a Nonbank Covered Company should be based on the appropriately tailored prudential standards that the Board should adopt in the separate rulemaking as suggested in section II of this letter.

For Nonbank Covered Companies that are insurers, we believe that the early remediation requirements should take into account the risk-based capital rules applicable to U.S. insurers. The U.S. insurance risk-based capital rules were developed in the early 1990s at the same time the PCA rules were developed for insured depository institutions. Each state has enacted a risk-based capital law that requires each insurer to file a uniform annual risk-based capital report, the form of which is maintained by the NAIC. The framework is similar to that of insured depository institutions – if an insurer's total adjusted capital begins to drop below each of the four designated risk-based capital levels, various levels of increased remedial action are required, ranging from the insurer preparing a plan proposing corrective actions it intends to take to eliminate the capital deficiency (which is subject to acceptance by the insurer's domestic state insurance regulator) to corrective actions imposed by order by the insurer's domestic state regulator. If an insurer's risk-based capital triggers a "mandatory control level event," the domestic state insurance regulator must seek to place the insurer into rehabilitation or liquidation (receivership).

Most importantly, the calculation of insurer risk-based capital is specifically tailored to the business risks to which an insurer is exposed. In the case of a life insurer, these risks include asset risk (including risks associated with derivatives and reinsurance), insurance risk (the risk of underestimating liabilities from business already written or inadequately pricing business to be written), interest rate risk and market risk (risk of losses due to changes in market levels associated with life insurer variable products with guarantees). The bank-centric early remediation framework simply is not appropriate for insurers.

Although the proposed early remediation framework is clearly bank-centric in design, its major flaw would negatively impact both Nonbank Covered Companies and the larger financial system. Specifically, there is a danger that the early remediation requirements will inappropriately cabin a covered company's ability to take actions necessary to mitigate its financial distress. For example, a covered company subject to Level 2 remediation could be prohibited from acquiring assets to hedge outstanding risks or engaging in certain asset/liability management activities that could enhance its overall liquidity position. If a covered company were prevented from taking such actions, the odd result would arise that the early remediation framework would be exacerbating exactly the types of problems that it was intended to mitigate. We submit that it would be counterproductive to require the imposition of restrictions and prohibitions that the Board could impose on a covered company anyway. In the absence of early remediation requirements, the Board would retain the ability to impose restrictions on a covered company's acquisitions, asset growth or capital distributions pursuant to its supervisory authority.

Because the early remediation framework is designed for Large BHCs, we believe that imposing bank-centric early remediation triggers on Nonbank Covered Companies would not only fail to achieve the purpose of the early remediation framework, but would also give rise to false positives that would mislead the Board into believing that the financial condition of the Nonbank Covered Company had deteriorated. In order to provide for triggers which accurately capture deteriorations in the financial condition of a Nonbank Covered Company, the Board should amend the final rule to explicitly provide that the early remediation framework will be tailored to the capital structure, risk profile, complexity, activities and size of the Nonbank Covered Company. In developing an early remediation framework that is appropriately tailored to the Nonbank Covered Company, we request that the Board remain cognizant of current and ongoing international efforts to develop new frameworks for effective prudential regulation of nonbank financial companies, several of which are likely to provide the Board with helpful information in designing an appropriately tailored early remediation framework.[32] The Board should seek to ensure that any early remediation requirements developed for Nonbank Covered Companies are harmonized with international regulatory standards to the greatest extent possible.

VIII. Conclusion

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

Respectfully submitted,

Julie A. Spiezio

CC: Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th St. & Constitution Ave, NW, Washington, DC 20551

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32 *See, e.g.*, Press Release, IAIS, Insurance and Financial Stability –Opening Remarks of Peter Braumiller, Chairman of the IAIS Financial Stability Committee (Nov. 15, 2011), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/13350.pdf (noting that the IAIS is developing an assessment methodology for globally systemically important insurers).