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March 20, 2013

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219
Docket IDs OCC-2012-0008, -009

Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Docket Nos. R-1430, R-1442; RIN No. 7100-AD87

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
FDIC RIN 3064-AD95

Re: **Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action; Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements**

Ladies and Gentlemen:

Enclosed is a copy of a letter submitted today to Scott G. Alvarez, Esq., General Counsel of the Board of Governors of the Federal Reserve System, by a group of law firms providing regulatory advice to insurance companies, including those that are savings and loan holding companies under the Home Owners Loan Act. In our letter, we emphasize the importance of proper treatment of such insurance companies under the

Basel III capital rules currently being developed by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (the "Agencies").[1]

Although we understand the comment period for the Agencies' proposed rules is closed, we ask that our comments be made a part of each agency's record. We hope the enclosed letter will be helpful to the Agencies and we appreciate the opportunity to provide our thoughts.

Sincerely,

A. Patrick Doyle

Enclosure

[1] *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action*, 77 FR 52791 (Aug. 30, 2012); *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements*, 77 FR 52887 (Aug. 30, 2012).

March 20, 2013

Scott G. Alvarez, Esq.
General Counsel
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW.
Washington, DC 20551

Re: <u>Collins Amendment</u>

Dear Mr. Alvarez:

On behalf of a group of law firms providing regulatory advice to insurance companies, including those that are savings and loan holding companies ("SLHCs") under the Home Owners' Loan Act ("HOLA"), we write to emphasize the importance of proper treatment of such insurance companies under the Basel III capital rules currently being developed by the Board of Governors of the Federal Reserve System ("FRB" or "Board"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, the "Agencies"). In particular, we write to address the Agencies' authority and flexibility, in implementing Senator Collins' amendment to the legislation that became the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA"),[1] to apply insurance-based capital standards to insurance companies that are SLHCs ("Insurance SLHCs").

Under Senator Collins' amendment, enacted as section 171 of the DFA ("Section 171"),[2] Congress directed the Agencies to establish minimum leverage capital requirements and minimum risk-based capital requirements, each to be met on a consolidated basis by depository institutions and their holding companies, including SLHCs. Congress did not prescribe the specific factors to be used in calculating capital amounts that meet these threshold requirements, but rather left that prescriptive task to the Agencies' discretion, in light of the Agencies' experience and expertise and the availability to the Agencies of guidance from other regulators, including state insurance regulators.

The capital standards set forth in the notices of proposed rulemaking (the "Proposals") issued by the Agencies on June 7, 2012,[3] reflect almost exclusively the Agencies' consideration

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1 Pub. L. No. 111-203 (2010).

2 Codified at 12 U.S.C. § 5371.

3 Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt. Corrective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012); Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (Aug. 30, 2012).

of bank activities, assets and liabilities, and related risks. The Agencies do not appear to have seriously considered or made an attempt to use their authority to consider the different range of factors relevant to non-bank institutions subject to the Section 171 requirements, including, and in particular, Insurance SLHCs. As a result, the Proposals are extremely ill-fitted to the specific and unique risk profile characteristics of Insurance SLHCs and their insurance subsidiaries.

As discussed below, the text of Section 171, as well as that of section 616(b) – which specifically addresses capital levels of SLHCs – and numerous other provisions of the DFA, taken in the context of Congress' overall objectives for the statute, make clear that the Agencies have ample authority to adopt capital requirements applicable to Insurance SLHCs that properly take into account these specific and unique risk profile characteristics. Moreover, since the DFA's enactment, Senator Collins herself and numerous other Members of Congress have explicitly confirmed that the Agencies have both the authority and the responsibility to design the required capital standards in a manner that will account for insurance-specific factors and not just bank-centric factors. We therefore urge that the FRB alter the approach taken in the Proposals and design its final regulations to prudently incorporate the liability risks and current capital requirements that exist for the insurance industry.

A reasonable and appropriately tailored capital regime, coupled with FRB supervisory oversight at the holding company level, can address both the prudential and systemic risk concerns the Agencies intended to address through the Proposals. By incorporating existing insurance company capital requirements, the Agencies can ensure adequate capital at the Insurance SLHC holding company level without disrupting the business of insurance and the availability of long-term credit.

I. Background

A. Insurance SLHCs

Insurance SLHCs are unique entities in that they are not merely holding companies for companies engaged in the business of insurance – they are engaged in the business of insurance in their own right.[4] As such, an Insurance SLHC is regulated by state insurance regulators and, together with its subsidiaries, is included in the state regulators' assessments of the Insurance

4 Many Insurance SLHCs are "grandfathered" unitary SLHCs, as defined in section 10(c)(9)(C) of the HOLA. Under that provision, if a company was an SLHC on May 4, 1999 (or became an SLHC pursuant to an application pending on or before May 4, 1999) and currently continues to control at least one savings association that it then controlled and that qualifies as a "qualified thrift lender" (as defined in section 10(m) of the HOLA), the SLHC is not subject to the HOLA's restrictions on certain. SLHC activities. 12 U.S.C. § 1467a(m). Typically, the operations of the thrift subsidiaries of such Insurance SLHCs are vastly dwarfed in size by the insurance operations of the parent Insurance SLHC and its insurance company subsidiaries.

SLHC's capital adequacy.[5] Each such subsidiary that is an insurance company is also subject to supervision and regulation by the insurance department in its state of domicile.

Insurance is among the most highly regulated industries in the United States. State insurance regulations comprise a comprehensive framework of financial, solvency, and market conduct rules. These rules – including a rigorous capital regime – have been developed over time, principally through the National Association of Insurance Commissioners ("NAIC"). They include requirements for, inter alia, on-site risk-focused examinations; reserves, capital adequacy, and solvency; regulatory control of significant, broad-based risk-related transactions/activities; preventive and corrective measures, including enforcement; and supervised exit from the market and receivership in the event of insolvency.

The state insurance solvency regulations are designed to ensure that all insurance companies, including Insurance SLHCs, have the financial ability to pay claims. Among other things, state insurance regulators require insurers to conduct regular "stress tests" using conservative assumptions to test insurance company reserves in the context of insurers' liabilities. These rules are carefully calibrated to address the particular risks facing insurers – which are markedly different from the risks facing banking institutions, as Chairman Bernanke effectively acknowledged in his recent testimony before the House Committee on Financial Services on February 27, 2013.[6]

The direct state regulation of specific insurance operations and investments, renders an Insurance SLHC's activities subject to close regulatory scrutiny. Notably, such comprehensive regulation did not exist in the case of AIG Financial Products, as the AIG holding company, although it was a SLHC, was not itself an insurance company. The lack of effective supervisory oversight of holding company activities and risk management practices across the AIG enterprise was central to the company's overall liquidity crisis in 2008.[7]

Ownership of FDIC-insured federal savings banks by Insurance SLHCs has resulted in federal regulation of those Insurance SLHCs as an additional layer of supervision and protection. Moreover, as discussed further below, Congress has specifically requested that the Board use the

[5] See, e.g., N.Y. Ins. Law §§ 1322-25 (implementing the National Association of Insurance Commissioners Risk-Based Capital for Insurers Model Act).

[6] Monetary Policy and the State of the Economy, Hearing Before the House Comm. on Fin. Servs. (Feb. 27, 2013) ("[W]e recognize that there are important differences between banks and insurance companies.") (testimony of Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System).

[7] As observed in the 2011 report of the Financial Crisis Inquiry Commission, "state insurance supervisors were barred from regulating AIG's sale of credit default swaps even though they were similar in effect to insurance contracts. If they had been regulated as insurance contracts, AIG would have been required to maintain adequate capital reserves, would not have been able to enter into contracts requiring the posting of collateral, and would have not been able to provide default protection to speculators; thus AIG would have been prevented from acting in such a risky manner." Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis, at 279, 352 (Jan. 27, 2011), available at http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

existing, proven measures of prudent insurance capital levels as fundamental pillars of its capital regulations applicable to Insurance SLHCs. As stated by more than 30 Members of Congress:

> The final rules should reflect and consider the unique insurance business model without undermining prudential supervision. We ask that the Federal Reserve, including the regional Federal Reserve Banks, consult with the National Association of Insurance Commissioners (NAIC), to design appropriate capital requirements specifically for insurance that complement existing state regulatory requirements.[8]

This statement explicitly confirms what Section 171 and the DFA as a whole implicitly convey: Congress' intent that the Board construct its Insurance SLHC capital framework by incorporating – not supplanting – current state insurance capital regimes.

B. NAIC Risk-Based Capital Standards

The NAIC, together with the individual state insurance regulators it represents and who implement its recommendations, has established a risk-based capital ("RBC") framework for entities engaged in the business of insurance. The foundation of RBC is statutory accounting where both assets and liabilities are valued conservatively. This results in an appropriate measure of surplus and provides for a long-term-oriented asset/liability matching approach that reflects the longer-term nature of insurance company investments. RBC also recognizes the unique characteristics of insurance companies' business models and balance sheets, which are very different from those of banks. Specifically, it recognizes that premiums are collected in advance and invested ahead of anticipated claims. Unlike banks, which are typically exposed to large amounts of highly liquid demand deposits, insurers have longer-term liabilities and therefore find that longer-term assets, even those with higher short-term volatility, can often pose less risk and be a key component to the long-term viability and financial strength of an insurer.

In addition to capturing credit risk of fixed income investments and the risk of fair value losses from equity (and similar) investments, RBC also captures many other risks, such as asset risk, insurance/underwriting risk, interest rate risk, and business risk, as well as differentiating between insurance industry product/business line structures (life, property/casualty, and health). RBC has served for more than two decades as an effective regulatory framework to limit insurance insolvencies and preserve insurers' financial strength, as was highlighted during the financial crisis, when insurance companies were among the few financial services entities to be largely unaffected. Indeed, according to the 2011 report of the Financial Stability Oversight Council ("FSOC"), just 28 of approximately 8,000 insurers became insolvent in 2008 and 2009.[9]

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[8] Letter from Members of Congress to Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, dated December 11, 2012, at 2.

[9] FSOC, 2011 Annual Report, 61. The FSOC also reported that, "as the crisis has unfolded, 370 bank and thrift failures occurred through June 30, 2011, or 4.5 percent of institutions operating at the beginning of 2008." Id. at 58. During that same time 0.35% of insurers became insolvent. Id. at 61. Also notably,

Footnote continued on next page

As discussed below, the Agencies have ample authority, under the statutory text of the DFA and based on other indications of Congressional intent, to incorporate RBC and other appropriate standards for Insurance SLHCs into their capital rules implementing the Basel accords and the DFA, and specifically Section 171.

II. The Agencies Have Ample Authority Under the Collins Amendment to Apply Capital Standards to Insurance SLHCs That Appropriately Reflect Insurance Realities.

A. Statutory Text and Regulatory Discretion

Section 171 provides that Agencies "shall establish minimum leverage capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors."[10] It sets forth the same directive with respect to minimum risk-based capital requirements. With respect to both sets of minimum requirements, Section 171 mandates that they:

> shall not be less than the generally applicable [leverage/risk-based] capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable [leverage/risk-based] capital requirements that were in effect for insured depository institutions as of July 21, 2010.[11]

This directive does not compel the use of any particular factors or methodology to determine the calculation of minimum capital of a particular type of regulated institution, nor require use of the same methodology across the board for all SLHCs. Instead, it grants the Agencies discretion to take into account whatever factors and methodologies are appropriate in relation to the assets and liabilities of a given regulated institution, including an Insurance SLHC, in order to prescribe capital levels not "less than" nor "quantitatively lower than" the minimum bank risk based and leverage capital requirements.[12] By using a comparative, non-absolute standard for measuring capital requirements, Section 171 intentionally gave the Agencies the flexibility to design appropriate measures for, inter alia, Insurance SLHCs.

Such a delegation of regulatory discretion is highly typical, particularly in an area of complex regulation. As the U.S. Supreme Court has observed with respect to agency discretion under the Internal Revenue Code, for example:

Footnote continued from previous page

only three insurance enterprises participated in the Capital Purchase Program under TARP, in contrast to 705 banking institutions. (source: TARP website)

10 12 U.S.C. § 5371(b)(1)-(2).

11 Id.

12 Id.

> Filling gaps in the Internal Revenue Code plainly requires the Treasury Department to make interpretive choices for statutory implementation at least as complex as the ones other agencies must make in administering their statutes. We see no reason why our review of tax regulations should not be guided by agency expertise . . . to the same extent as our review of other regulations.

Mayo Found. for Med. Educ. & Research v. United States, 131 S. Ct. 704, 713 (2011) (citing Bob Jones Univ. v. United States, 461 U.S. 574 (1983) ("[I]n an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems"). See also, e.g., Nat'l Cable & Telecommunications Ass'n, Inc. v. Gulf Power Co., 534 U.S. 327, 339 (2002) ("[Particularly where] the subject matter . . . is technical, complex, and dynamic; and as a general rule, agencies have authority to fill gaps where the statutes are silent.").

The "gaps" Congress left in Section 171 for the Agencies to fill in include the appropriate risk-weights, asset types, and accounting methodologies to apply in establishing minimum leverage and risk-based capital requirements for Insurance SLHCs and their insurance subsidiaries. For example, Section 171 does not suggest that particular types of assets should be treated as high-risk in all contexts across different types of regulated institutions. It does not indicate, for example, that Congress would want the Agencies to treat long-term investments as more risky than short-term investments in the insurance context, where reality is to the contrary, as discussed above. Rather, Section 171 indicates, by leaving statutory "gaps" regarding the content of the regulations the Agencies are charged with promulgating, that the Agencies should use their experience, expertise, and access to the guidance of other regulators, coupled with all available information and analyses, to prescribe capital standards tailored to the actual risks facing the various and particular types of regulated institutions to which the standards will apply. See Chevron, U.S.A., Inc. v. Natural Res. Defense Council, Inc., 467 U.S. 837, 843 (1984) ("'The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress.'" (quoting Morton v. Ruiz, 415 U.S. 199, 231 (1974))).

This is underscored by numerous other provisions of the DFA, which inform a proper understanding of Section 171. "Statutory interpretation focuses on 'the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.'" AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1754 (2011) (quoting Robinson v. Shell Oil Co., 519 U.S. 337, 341 (1997) (emphasis added)); see also Norman J. Singer & J.D. Shambie Singer, 2A Sutherland Statutory Construction § 47:2 (7th ed. 2007, Supp. 2012) ("[T]he entire act must be read together because no part of the act is superior to any other part. . . . [A]ny attempt to segregate any portion or exclude any other portion from consideration is almost certain to distort the legislative intent."); United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 371 (1988) ("Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme-because the same terminology is used elsewhere in a context that makes its meaning clear . . . or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.") (citations omitted).

The Agencies' broad authority – and responsibility – under Section 171 to utilize and rely upon the experience and expertise of other regulators, including state insurance regulators, and the capital standards they have developed is evident from the DFA as a whole. For example, section 604 of the DFA, which amended the Bank Holding Company Act and the HOLA to include new requirements for regulatory supervision, examinations, and reporting, specifically requires the Board to use, to the fullest extent possible, reports and information provided to other federal and state regulatory agencies, including externally audited financial statements of a SLHC subsidiary.[13] Section 604 also requires the Board to rely, to the fullest extent possible, on "the examination reports made by other Federal or State regulatory agencies relating to a savings and loan holding company and any subsidiary."[14] And it further requires the Board to coordinate and consult with "the appropriate . . . State regulatory agency . . . for a functionally regulated subsidiary of a [SLHC] before commencing an examination of the subsidiary under this section."[15]

These and other textual provisions of the DFA plainly demonstrate that the Agencies have the authority under Section 171 – an authority Congress intended the Agencies to utilize and not ignore – to consult with, learn from, and rely on the experience and expertise of state insurance regulators in prescribing standards, including capital standards, applicable to Insurance SLHCs.[16]

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[13] 12 U.S.C. § 1467a(b)(2)(B).

[14] Id. at § 1467a(b)(4)(B).

[15] Id. at § 1467a(b)(4)(C).

[16] See, e.g., DFA § 113(a)(2)(H) (directing that, prior to designating a nonbank financial company as systemically important, the FSOC must (i) consider, among other factors, "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies," and (ii) consult with the primary financial regulatory agency of any such nonbank financial company); DFA § 115 (requiring the FSOC to conduct a study of the feasibility, benefits, costs and structure of a contingent capital requirement for nonbank financial companies and to consider, inter alia, "capital requirements applicable to a nonbank financial company . . . and subsidiaries thereof"); DFA § 165(d)(1)(A) (providing for reporting to the Board, the FSOC, and the FDIC regarding resolution plans and credit exposure risk, including "information regarding the manner and extent to which any insured depository institution affiliated with the [reporting] company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company," which would include the resolution plans for insurance company subsidiaries in accordance with state law); DFA § 169 (requiring the Board to "avoid imposing requirements . . . that are duplicative of requirements applicable to bank holding companies and nonbank financial companies under other provisions of law"); DFA § 203(e) (providing that orderly liquidation of a covered financial company that is an insurance company, or an insurance subsidiary of a covered financial company, shall be conducted under applicable state law); DFA § 619 (providing that a "regulated insurance company directly engaged in the business of insurance" may make investments for its general account that would otherwise be considered impermissible proprietary trading under the DFA, provided the investment complies with state insurance company investment laws. Federal banking agencies may only disallow such investments under certain conditions and "after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners . . . .").

B. Legislative History

In addition to the text of Section 171 and other DFA provisions, the statute's legislative history underscores that Congress did not constrain the Agencies from tailoring capital requirements to fit the different risk profiles of the various different types of institutions subject to the minimum capital thresholds set by Section 171. Analysis of legislative history is, of course, a traditional tool of statutory construction. See Norman J. Singer & J.D. Shambie Singer, 2A Sutherland Statutory Construction § 45:9 (7th ed. 2007, Supp. 2012) ("to determine legislative intent the court should look to the apparent statutory purpose as disclosed by the language in light of the legislative history.") (citation omitted); Zuni Pub. Sch. Dist. No. 89 v. *Dep't of Educ.*, 550 U.S. 81, 106 (2007) ("There is no reason why we must confine ourselves to, or begin our analysis with, the statutory text if other tools of statutory construction provide better evidence of congressional intent with respect to the precise point at issue.") (Stevens, J., concurring); Wisconsin Pub. Intervenor v. Mortier, 501 U.S. 597, 610, n. 4 (1991) ("Our precedents demonstrate that the Court's practice of utilizing legislative history reaches well into its past. We suspect that the practice will likewise reach well into the future.") (internal citation omitted).

With respect to capital standards applicable to Insurance SLHCs in particular, the legislative history of Section 171 confirms that Congress, rather than mandating a rigid, bank-centric approach with respect to capital, left a "gap" for the Agencies to fill by prescribing appropriately tailored capital standards for such SLHCs. Importantly, Congress suggested its intention for properly filling that "gap" in addressing the more specific DFA provision targeted to capital levels of SLHCs – section 616(b) of the DFA ("Section 616(b)"). As the legislative history clearly states regarding the capital rules to be promulgated for SLHCs:

> It is the intent of the Committee that in issuing regulations relating to capital requirements of . . . savings and loan holding companies under this section, the Board should take into account the regulatory accounting practices and procedures applicable to, and capital structure of, holding companies that are insurance companies (including mutuals and fraternals), or have subsidiaries that are insurance companies.[17]

Although Congress did not make such a specific statement in discussing Section 171, that is entirely understandable, as Congress did not focus on SLHCs – much less Insurance SLHCs – as the principal target of Section 171. But because "[a] specific provision controls over one of more general application," Gozlon-Peretz v. United States, 498 U.S. 395, 407 (1991), the legislative history of Section 616(b) is plainly instructive of Congress' intent with respect to Section 171's application to Insurance SLHCs.

One would not have expected Congress to provide such specific intent in addressing Section 171 itself, given that, as reflected in the public statements of Senator Collins, the principal focus of her amendment was to require large bank holding companies ("BHCs") and

[17] Senate Report 111-176 (2010) at 89.

nonbank financial companies not otherwise subject to the capital and solvency standards applicable to insurance companies to meet the capital standards applicable to small banks. The specific focus was not on SLHCs, and certainly not on SLHCs already subject to comprehensive capital and solvency regulation.

This is clear from, among other things, the statement of Senator Collins when she introduced her amendment on the Senate floor:

> The Collins-Shaheen amendment directs Federal regulators to impose minimum leverage and risk-based capital requirements on banks, bank holding companies, and those nonbank financial firms identified by the new Financial Stability Oversight Council for supervision by the Federal Reserve. . . .
>
> Our amendment would tighten the standards that would apply to larger financial institutions by requiring them to meet, at a minimum, the standards that already apply to small banks. This only makes sense. If a small bank fails, the FDIC can close down that bank over a weekend, allow it to operate, avoid a run on the bank, and deal with it in an orderly way. But if a large bank holding company fails, it is so interconnected in our economy that it sets off a cascade of dire economic consequences. . . .
>
> Our amendment would tighten the standards that would apply to larger financial institutions by requiring them to meet, at a minimum, the standards that already apply to small banks.[18]

In a statement of support for the Collins Amendment, then-FDIC Chairman Sheila Bair also framed the need for the amendment in terms of BHCs:

> During the crisis, FDIC-insured subsidiary banks became the source of strength both to the holding companies and holding company affiliates. Far from being a source of strength to banks as Congress intended, holding companies became a source of weakness requiring federal support. If, in the future, bank holding companies are to become sources of financial stability for insured banks, then they cannot operate under consolidated capital requirements that are numerically lower and qualitatively less stringent than those applying to insured banks. This amendment would address this issue by requiring bank holding companies to operate under capital standards at least as stringent as those applying to banks.[19]

In congressional testimony, Chairman Bair reiterated that large BHCs and nonbank financial companies supervised by the Federal Reserve after a designation as a systemically important financial institution ("SIFI") were the focus of the Collins Amendment. Speaking

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[18] Cong. Rec. S3459 (daily ed. May 10, 2010) (statement of Sen. Collins).

[19] Cong. Rec. S3460 (daily ed. May 10, 2010) (Exhibit 1, letter from Chairman Sheila C. Bair to Sen. Collins).

before a subcommittee of the Committee on Oversight and Government Reform, Chairman Bair testified:

> In my view, this is the single most important provision of the Act for strengthening the capital of the U.S. banking system and leveling the competitive playing field between large and small U.S. banks. Section 171 essentially says that risk-based and leverage capital requirements for large banks, bank holding companies, and nonbanks supervised by the Federal Reserve Board may not be lower than the capital requirements that apply to thousands of community banks nationwide. Without the Collins amendment, our current rules set a course to allow the risk-based capital requirements of our largest banks to be governed by the assumptions of bank management regarding the riskiness of their own exposures. In my view, such an approach would eventually create the conditions for another leverage-driven banking collapse.[20]

Implicit in the comments of Senator Collins and then-Chairman Bair is the very legitimate concern that the burden of resolving complex BHCs and SIFIs not otherwise subject to specific solvency and resolution regimes applicable to insurance companies will again fall on taxpayers as it did during the financial crisis. The Collins Amendment is an effort to make this burden less likely by creating a capital floor applicable to depository institution holding companies, using the current requirements for insured depository institutions as a baseline.

The concerns that motivated the Collins Amendment do not apply to Insurance SLHCs or to insurance SIFIs that are subject to specific solvency and resolution regimes. As discussed above, insurance companies that themselves are SLHCs, as well as their insurance subsidiaries, are resolved according to the procedures set forth in state insurance solvency laws.[21] The burden of an insolvent insurance company does not fall on the FDIC or the federal government and federal taxpayers generally. To the extent that consolidated capital requirements for BHCs and non-Insurance SLHCs are necessary to limit FDIC exposure or to prevent taxpayer involvement, this is not the case with respect to Insurance SLHCs.

C. Post-Enactment Clarifications

The indications of Congressional intent in the legislative history of the DFA regarding appropriate treatment of Insurance SLHCs and insurance companies designated as SIFIs are supplemented and reinforced by express post-enactment clarifications of that intent, specifically in response to the Proposals. These post-enactment statements expressly voice Congress' concern with the Proposals' apparent disregard for the critical distinctions relevant to capital adequacy for insurance companies compared to banking institutions.

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[20] The Changing Role of the FDIC Before the Subcomm. on TARP, Fin. Services, and Bailouts of Public and Private Programs of the H. Comm. on Oversight and Government Reform, 112th Cong. (June 22, 2011) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) (emphasis added).

[21] See DFA § 203(e).

For example, in a letter sent to the Agencies in October 2012, at the time other comments were submitted on the Proposals, almost one quarter of the entire U.S. Senate wrote that "[w]e are concerned that some of the proposed rules, as drafted, do not reflect the distinct nature of the insurance business or take into consideration the state risk-based capital system that was specifically developed for the insurance industry and refined over the past 20 years."[22] As the Senators explained:

> As you know, insurance companies are regulated by state insurance agencies where insurance companies are domiciled or are licensed to sell insurance. While we recognize that the Dodd-Frank Act directs the federal banking agencies to establish minimum capital standards on a consolidated basis, Congress did not intend for federal regulators to discard the state risk-based capital system in favor of a banking capital regime. In fact, the Committee Report that accompanied the Senate-passed Restoring American Financial Stability Act provided direction to the federal banking agencies to consider insurance companies' existing regulatory requirements, accounting treatment, and unique capital structures in developing capital requirements for insurance entities. Any final regulations should reflect the will of Congress to respect the distinctions between insurance and banking.[23]

The Senators also highlighted the specific differences between banking and insurance activities that the Proposals do not adequately take into account:

> Applying a bank-centric capital system to insurance-based holding companies raises significant concerns. Any regulatory regime must acknowledge how insurance companies rely upon long-term assets to fund long-term liabilities. By contrast, banks have a range of investments and use a variety of bonds, equity, and short-term debt to fund their operations. Asset-liability matching is fundamental to the insurance business, and any regulatory capital regime should recognize that applying a bank-centric capital regime to the insurance industry would fundamentally alter the nature of the business.[24]

Shortly thereafter, Senator Collins herself wrote to the Agencies to express similar concerns. In a letter dated November 26, 2012, she stressed that the Proposals reflected either a misunderstanding of Section 171 or a misguided view of how Congress intended the Agencies to implement the statute. As her letter explains:

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[22] Senators' Letter to Ben S. Bernanke, Martin J. Gruenberg, and Thomas J. Curry dated Oct. 17, 2012, at 1.

[23] Id. at 1-2 (emphasis added).

[24] Id. at 2.

> [I]t was not *Congress's intent that federal regulators supplant* prudential state-based insurance regulation with a bank-centric capital regime. Instead, consideration should be given to the distinctions between banks and insurance companies, a point which Chairman Bernanke rightly acknowledged in testimony before the House Banking Committee this summer. For example, banks and insurers typically have a different composition of assets and liabilities, since it is fundamental to insurance companies to match assets to liabilities, but this is not characteristic of most banks. I believe it is consistent with my amendment that these distinctions be recognized in the final rules.[25]

Subsequently, in a separate letter sent to Chairman Bernanke, more than 30 Members of Congress weighed in with their additional objections the Proposals' apparent disregard for the differences between banking and insurance. Echoing the Senators' statements, these Members confirmed that the "bank-centric approach of the proposed rules is inconsistent with the unique nature of insurance and contradicts the intent of Congress."[26] They expressly "ask[ed] that the [final] rules consistently reflect congressional intent by incorporating the state risk-based capital system and applying capital standards that accommodate the existing framework for companies engaged in the business of insurance."[27]

As the Members observed:

> Strong capital standards need to be consistent with the business models of the industry to which they are applicable. As you are aware, not all companies have the same business model and risk profile. Because of this reality, it is not workable to have one uniform capital standards regulation to apply across the whole spectrum of financial services companies. Recently, you acknowledged before Congress that "insurance companies have both a different composition of assets and a different set of liabilities, and appropriate regulation needs to take that into account." We are concerned the proposed rules do not consider these differences, nor do they take into account the state regulatory standards for insurance companies that emphasize long term solvency.[28]

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[25] Letter from Senator Susan M. Collins to Ben S. Bernanke, Martin J. Gruenberg, and Thomas J. Curry dated Nov. 26, 2012, at 2 (emphasis added).

[26] Letter from Members of Congress to Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, dated December 11, 2012, at 1.

[27] Id.

[28] Id.

The Members also specifically criticized the Proposals for their apparent disregard of the existing framework of insurance solvency regulation and its role in the proper standards for insurance company capital adequacy. As they noted:

> [A]ll insurers are required by law to annually report on their financial health using Statutory Accounting Principles (SAP), which are specifically designed for insurance company solvency regulation. The proposed rules' sole reliance on Generally Accepted Accounting Principles (GAAP) for an insurance company can result in a different set of measurements and incentives that are not always consistent with insurer solvency standards. Furthermore, for insurance companies not currently required to prepare financial statements using GAAP, a new mandate requiring additional statements using GAAP would be costly with no improvement in understanding the financial health of the insurance company. It is important the Federal Reserve utilize existing, less costly and more appropriate alternatives in order to review the financial health of a holding company that has a depository institution.[29]

In conclusion, the Members requested that the final rules "reflect and consider the unique insurance business model without undermining prudential supervision." They urged the FRB, including the regional Federal Reserve Banks, to consult with the NAIC to design "appropriate capital requirements specifically for insurance that complement existing state regulatory requirements.[30]

As these multiple statements of clear Congressional intent plainly demonstrate, the ambiguous text of Section 171 cannot be read in a vacuum or with bank-centric blinders. Section 171 must be read in context, which includes the numerous indications, both in other sections of the DFA and in clarifications such as those quoted above, that Congress intended Section 171 to be applied in a manner that accounts for the particular types of risk exposure faced by different types of financial institutions, including Insurance SLHCs and insurance companies designated as SIFIs.

III. The FRB Has Ample Tools to Design Capital Standards That Will Appropriately Reflect The Risk Profiles of Insurance SLHCs.

As noted, "ambiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion." Nat'l Cable *& Telecomm. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 980 (2005). "If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation." Chevron, 467 U.S. at 843-44

[29] Id. at 2.

[30] Id.

(1984). Congress clearly intended the Agencies to fill the "gap" left by Section 171 with respect to designing capital standards most appropriate for Insurance SLHCs, using not only their own experience and expertise but also that of the state insurance regulators and other insurance experts.

Congress had firm grounds for expecting the Agencies to use their authority under Section 171 by consulting with and relying on proven methods of insurance capital regulation. As early as 2002, FRB staff recognized the difficulties associated with attempting to "fit" insurers into the BHC model of capital regulation, noting in a 2002 joint report of FRB staff and the NAIC that the different capital approaches used by the regulators of insurance companies and banks reflect the inherent differences between the insurance and banking industries.[31] 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.[32]

The Basel capital framework focuses substantially on assets, rather than taking a more holistic approach that recognizes the value of stable liabilities or financing concerns. In essence, the Proposals thereby ignore the most important element of insurer risk management. The NAIC RBC framework has successfully addressed these risks on an integrated basis, and under the DFA, NAIC RBC remains the recognized standard for regulatory actions regarding insurance activities.[33] Utilizing an equivalency approach and the calibration of required capital, NAIC RBC can be incorporated into a consolidated risk-based capital requirement for Insurance SLHCs.

Applying NAIC RBC in this manner (i.e., effectively recognizing an "insurance book" in addition to the trading and banking books) is consistent with the Basel II and III framework.[34] Taking such an approach in the Agencies' final capital rules would align them with the guidance of the recently released "Principles for the supervision of financial conglomerates," pursuant to which financial institution "[s]upervisors should apply every effort to avoid creating undue burden through duplication and conflicts between the sectoral standards applied at the conglomerate level.[35]

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

32 2002 Joint Report. 3.

33 See DFA section 313(k).

34 See paragraphs 30, 33 and 34 of the Basel II Revised Framework. Under Basel II, assets and liabilities of insurance subsidiaries are deducted and an adjustment to bank capital may be made to reflect the surplus capital in the insurance subsidiary (e.g., the capital in excess of insurance regulatory requirements that is available to be transferred to the parent company) with this residual capital risk-weighted as an equity investment.

35 The Joint Forum: Basel Committee on Banking Supervision, International Organization of Securities Commissions, and International Association of Insurance Supervisors, Principles for the supervision of financial conglomerates, at 5-6 (Sept. 2012) (www.bis.org/publ/joint29.pdf).

In the comments submitted to the Agencies on the Proposals, a number of alternative approaches were suggested to accomplish these objectives, consistent with the "not quantitatively less than" requirement of Section 171. The Agencies are well-equipped, and have ample external sources of guidance, to assess these alternatives and others and offer new proposed capital rules for application to Insurance SLHCs and insurance companies designated as SIFIs. Such rules can readily be designed to use NAIC RBC for Insurance SLHCs and their insurance subsidiaries, while making any non-insurance company subsidiary of a SLHC (including the thrift subsidiary) subject to the Basel capital standards with appropriate adjustments for the existing capital treatment and regulation of the subsidiaries. Indeed, this point was expressly stated in a recent resolution of the National Conference of Insurance Legislators, which "calls on the Federal Reserve to revisit and revise its proposed regulations to tailor them in accordance with Congressional intent" by, among other things, "[a]pplying prudential requirements only to activities that are not subject to state insurance regulation as the Federal Reserve sees fit."[36]

The Agencies have ample time to accomplish these objectives consistent with their statutory mandate. Recognizing the significant analysis and resources that would be required to implement a new comprehensive consolidated capital framework on SLHCs, Section 171 provides for a five-year implementation period. The Agencies and the industry will benefit from taking advantage of this full period to ensure that rules are properly drafted and properly implemented. Just as the Board has granted BHCs that are subsidiaries of foreign banking organizations the benefit of the full five years for implementation of their new capital requirements, so too should the Board utilize the same period with respect to Insurance SLHCs. Moreover, just as these BHCs will continue to be subject to home-country consolidated capital requirements through their parent organizations during this implementation period, so too will Insurance SLHCs continue to be subject to comprehensive supervision by relevant state insurance regulators, including applicable capital requirements. Therefore, taking advantage of this extra time will give rise to no meaningful increase in risk to the financial system.

IV. Conclusion

As drafted, the Proposals are inconsistent with Congress' intent, as indicated in the text of the DFA, the statute's legislative history, and explicit post-enactment statements of Senator Collins and her colleagues – both in the Senate and the House. In clarifying Section 171's intent, Congress has confirmed that the statute should be read to require that equivalent capital standards be imposed on depository institution holding companies according to the particular nature of their risks, and not through a counterproductive one-size-fits-all approach. In particular, they have explicitly directed the Agencies to rework the bank-centric approach taken in the Proposals in order to reflect the unique asset base and risk profiles of Insurance SLHCs.

[36] National Conference of Insurance Legislators (NCOIL), Resolution Regarding the Prudential Regulation of Insurance, adopted by the NCOIL Executive Comm. on March 10, 2013 and by the State-Federal Relations Comm. on March 8, 2013.

We appreciate the opportunity to submit our views and would be honored for the opportunity to discuss them with you and your staff.

Very truly yours,

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