THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

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Via Electronic Submission

April 30, 2013

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Re: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (FR Doc. 2012-30734 & RIN 7100 AD 86)

Dear Mr. deV. Frierson:

The Financial Services Roundtable[1] (the "Roundtable") welcomes the opportunity to provide the Board of Governors of the Federal Reserve System (the "Board") with comments on the proposed rule (the "Proposed Rule") implementing section 165 and section 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") with respect to foreign banking organizations ("FBOs") and foreign nonbank financial companies ("Foreign NFCs").[2] In this letter, we offer specific comments on aspects of the Proposed Rule relating to Foreign NFCs potentially subject to designation by the Financial Stability Oversight Council (the "Council") under section 113(b) of the Dodd-Frank Act.

I. Executive Summary

The Roundtable strongly believes that the Proposed Rule as drafted is deficient with respect to Foreign NFCs. Most importantly, because the Proposed Rule is drafted almost entirely from the perspective of FBOs, and therefore does not provide any

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1 The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

2 Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76,628 (Dec. 28, 2012).

substantive discussion of how its provisions would apply to the U.S. activities and subsidiaries of Foreign NFCs, the Proposed Rule does not provide these companies with a fair or adequate basis for commenting on its possible effects. The Roundtable therefore believes that the Board should revise the Proposed Rule to exclude Foreign NFCs, and undertake a separate rulemaking with respect to Foreign NFCs.

As we discuss below, Section 102(c) of the Dodd-Frank Act specifically limits the application of any prudential or early remediation measure for any Foreign NFC that may be designated by the Council to the U.S. activities and subsidiaries of the NFC. In light of this specific statutory directive, we request that the Board clarify in any rule that it may ultimately adopt for Foreign NFCs that the prudential and early remediation measures apply only to the U.S. activities and subsidiaries of any Foreign NFC that may be designated by the Council.

As we also discuss below, similar to domestic nonbank financial companies designated by the Council under section 113 of the Dodd-Frank Act ("Domestic NFCs"), the Board is required by the provisions of Title I of the Dodd-Frank Act to tailor its application of the enhanced prudential standards and early remediation requirements of sections 165 and 166 of the Dodd-Frank Act to the capital structure, financial activities, size, and other characteristics of the U.S. activities and subsidiaries of a particular Foreign NFC. The Board is also required under section 165(b)(2) of the Dodd-Frank Act to give due regard to the principle of national treatment and equality of competitive opportunity, and to take into account the extent to which a Foreign NFC is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States. These statutory directives are applicable to any prudential measure the Board might propose, including an intermediate holding company requirement.

As we also note, the Financial Stability Board (the "FSB") is developing enhanced measures for the supervision of global systemically important financial institutions. The Board should, through both its role on the FSB and in this rulemaking, make every effort to avoid outcomes that would add to a Foreign NFC's compliance burden without clear corresponding benefits or that would create competitive inequality or disadvantage a particular Foreign NFC. Minimizing overlap, duplication or conflict in regulatory measures is an important principle in the development of any regulatory framework, and we believe this principle is particularly important when establishing the regulatory framework under sections 165 and 166.

In this letter, we also offer detailed comments on specific enhanced prudential standards and early remediation requirements to demonstrate how the Board's failure to tailor the Proposed Rule or otherwise substantively address the issues presented by the application of enhanced standards to Foreign NFCs has led to a Proposed Rule that is inappropriate for application to the U.S. activities and subsidiaries of a Foreign NFC. In our comments, we focus in particular on the potential inappropriate application of the proposed standards to the U.S. activities and subsidiaries of Foreign NFCs that are insurance enterprises.

II. Scope of Application of Proposed Rule

The Proposed Rule would implement the enhanced prudential standards and early remediation requirements of section 165 and section 166 of the Dodd-Frank Act for FBOs with $50 billion or more in total consolidated assets and for such Foreign NFCs as may ultimately be designated by the Council under section 113(b) of the Dodd-Frank Act. As the Board notes in the preamble to the Proposed Rule, the Council generally may determine that a U.S. or a foreign nonbank financial company should be subject to supervision by the Board if the Council determines that material financial distress of the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the company, could pose a threat to the financial stability of the United States. The test for designation of either a U.S. nonbank financial company *or* a foreign nonbank financial company is the threat to the financial stability of the United States.

As we discuss below, international bodies are in the process of implementing mechanisms to designate global systemically important financial institutions, including insurance groups. The designation of a global systemically important insurer by an international body, such as the FSB, does not imply that the insurer can or should be designated by the Council under section 113. The standards and methodology for designation by the FSB differ from the standards and methodology provided in section 113 of the Dodd-Frank Act. The Council must make its determination of designation under the statutory determination standards and considerations specified in section 113 of the Dodd-Frank Act. These statutory standards and considerations relate exclusively to the financial stability of the United States. We note that the Council itself has confirmed this approach to section 113 in the preamble to its final rule and interpretive guidance issued in April 2012.[3] In the preamble to the final rule and interpretive guidance, the Council stated that it intended to calculate the Stage 1 thresholds in its interpretive guidance solely based on the U.S. assets, liabilities and operations of a Foreign NFC and its subsidiaries.

An important corollary to the preceding point is that the application of prudential standards for any Foreign NFC designated by the Council must be limited to the U.S. activities and subsidiaries of the Foreign NFC, as required by section 102(c) of the Dodd-Frank Act. Section 102(c) is expressly designed for application to Foreign NFCs. It provides as follows:

> For purposes of the application of subtitles A [Council's authority] and C [Board's authority] (other than section 113(b) [designation of foreign nonbank financial companies]) with respect to a

3 *See* Authority to Require Supervision and Regulation of Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,645 (Apr. 11, 2012).

foreign nonbank financial company, references in this title to "company" or "subsidiary" include only the United States activities and subsidiaries of such foreign company, except as otherwise provided.

Section 102(c) addresses the issue of the extraterritorial effect of the designation of a Foreign NFC. Just as the determination by the Council under section 113 is limited to the threat to the financial stability of the United States, the supervisory response of the Board under sections 165 and 166 is limited to the U.S. activities and subsidiaries of the Foreign NFC. Considerations of international comity fully support this approach. We request that the Board clarify in any rule that it may ultimately adopt for Foreign NFCs that the prudential and early remediation measures apply only to the U.S. activities and subsidiaries of any Foreign NFC that may be designated by the Council.

III. Tailoring Required in the Proposed Rule

In December 2011, the Board released for comment a proposed rule (the "December 2011 Proposal") to implement sections 165 and 166 with respect to (i) U.S. bank holding companies with total consolidated assets of $50 billion or more ("Large BHCs") and (ii) Domestic NFCs.[4] The Roundtable and the Securities Industry and Financial Markets Association ("SIFMA") filed a joint comment letter, dated April 30, 2012, in response to the December 2011 Proposal (the "Joint Comment Letter").[5] One of the principal comments in the Joint Comment Letter was that the December 2011 Proposal was bank-centric and did not provide for the tailoring of the proposed standards to the differences between bank holding companies ("BHCs") and nonbank financial companies as required by the Dodd-Frank Act. The joint comment letter requested that the Board exclude Domestic NFCs from the December 2011 Proposal and commence a separate rulemaking to establish a process for tailoring the standards and requirements under sections 165 and 166 for any Domestic NFC. We hereby incorporate by reference the comments contained in the Joint Comment Letter with respect to the Proposed Rule.

The Proposed Rule generally adopts the same standards and requirements set forth in the December 2011 Proposal, but differs from the December 2011 Proposal in that it has been modified in an attempt to reflect the differences in structure between U.S. banking organizations and FBOs. Nonetheless, even with these modifications, the Proposed Rule remains bank-centric in its basic approach. In the preamble to the Proposed Rule, the Board indicates that it "expects" to tailor the application of the standards to different companies on an individual basis or by category, taking into

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

5 *See* Letter from the Roundtable and SIFMA, to the Board (Apr. 27, 2012), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs12/Section165-166FinalLetter4-27-12.pdf.

consideration their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors the Board deems appropriate. It also indicates that it "expects" to issue an order that provides clarity on how the enhanced prudential standards would apply to a particular Foreign NFC once such a company is designated by the Council.

The Roundtable appreciates these statements of the Board's expectations, but respectfully notes that the Dodd-Frank Act does not merely "expect," but instead *requires* the tailoring of the standards to both domestic and foreign nonbank financial companies. We note that in indicating that it expects to tailor the application of the standards to NFCs, the Board cites the provisions of section 165(a)(2) of the Dodd-Frank Act.[6] Section 165(a)(2) provides that the Board *may* differentiate among companies on an individual basis or by category, taking into account various factors. The discussion in the preamble to the Proposed Rule relating to NFCs, however, neglects to cite another relevant provision, section 165(b)(3). Section 165(b)(3) provides that the Board *shall* take into account differences among nonbank financial companies supervised by the Board and BHCs described in section 165(a) and *shall* adapt the required standards as appropriate in light of the predominant line of business of the nonbank financial company.

The Proposed Rule provides no indication of how its provisions would apply to the U.S. activities and subsidiaries of a Foreign NFC other than the statement that all of its provisions (other than possibly the intermediate holding company requirement) would apply to a Foreign NFC unless the Board determines that the application of a particular provision would be "inappropriate." The only discussion of Foreign NFCs in the preamble relates to the possible application of an intermediate holding company requirement to the U.S. activities and subsidiaries of a Foreign NFCs.[7] Otherwise, the preamble and the Proposed Rule provide no guidance on how the Board would determine whether the application of a provision is "inappropriate." Likewise, the preamble and the Proposed Rule provide no assurance that a designated Foreign NFC would have an opportunity to be heard on the questions of whether the application of the particular standards in the Proposed Rule would be "inappropriate" and how the standards would in any event be tailored to the Foreign NFC. We respectfully submit that the Proposed Rule and the preamble discussions do not provide a fair basis for commenting on the possible effects of the Proposed Rule on the U.S. activities and subsidiaries of Foreign NFCs.

The minimal discussion of Foreign NFCs in the preamble is striking in comparison to the extensive discussion of FBOs. We recognize the fundamental importance of the Proposed Rule to FBOs and do not minimize the need for an extensive

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6 77 Fed. Reg. at 76,634, n. 37.

7 We offer comments on the intermediate holding company provision in Section V of this letter.

discussion of the rationale and design of the Proposed Rule with respect to FBOs. The point that we would make is that the potential effects of the Proposed Rule are of equal importance to Foreign NFCs as they are to FBOs. These as-yet-to-be-designated entities are entitled to a full opportunity to comment on the effects of the Proposed Rule on their enterprises. In the subsequent sections of this letter, we offer observations on the application of the Proposed Rule to the U.S. activities and subsidiaries of Foreign NFCs, particularly those that are predominantly insurance enterprises. These comments, based on the application to a hypothetical Foreign NFC, are not in derogation of our view that the Proposed Rule should be revised to exclude Foreign NFCs and that a separate rulemaking should be undertaken with respect to these companies.

IV. International Processes and Considerations

Pursuant to the direction of the G20, the FSB is developing enhanced measures for the supervision of global systemically important financial institutions. Under the purview of the FSB, the International Association of Insurance Supervisors (the "IAIS") has designed a proposed methodology for designating global systemically important insurers ("G-SIIs").[8] The IAIS has also proposed for comment a set of policy measures that the relevant national insurance regulatory authorities would be expected to apply to any insurance enterprise designated as a G-SII.[9] The proposed policy measures relate to enhanced supervision, effective resolution, and higher loss absorption capacity for G-SIIs. The IAIS has indicated that it intends to recommend the first group of companies to the FSB for designation as G-SIIs in the first half of 2013. Governor Tarullo recently observed that it will be important for the IAIS process "to evaluate carefully the *actual* systemic risks associated with [insurance] companies."[10] The IAIS is currently considering the substantial comments received on its proposed policy measures.[11]

As noted earlier in this letter, the designation of a foreign insurance entity as a G-SII by the FSB is not determinative of whether that foreign insurance entity should be designated under section 113(b) of the Dodd-Frank Act. The designation determination under section 113(b) requires analysis by the Council of the potential threat posed by the foreign nonbank financial company to the financial stability of the United States. The G-

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8 IAIS, *Global Systemically Important Insurers: Proposed Assessment Methodology* (May 31, 2012).

9 IAIS, *Global Systemically Important Insurers: Proposed Policy Measures* (Oct. 17, 2012).

10 Daniel Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Address at the Cornell International Law Journal Symposium: The Changing Politics of Central Banks 13 (Feb. 22, 2013) (emphasis added).

11 The Roundtable has submitted comments on the proposed policy measures. *See* Letter from the Roundtable, to the IAIS (Dec. 14, 2012), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs12/IAISSIICommentLetter.pdf.

SII determination involves analysis by the FSB under the IAIS standards and methodology of the potential threat posed by an institution to global financial stability. It is possible, therefore, for an institution to be designated as a G-SII on the basis of its global footprint without triggering the Dodd-Frank Act's designation considerations. However, in the event that the FSB designates a foreign insurance entity as a G-SII and the Council separately determines that the same entity should be designated under section 113(b) based on a threat to the financial stability of the United States, there would be the potential for overlapping, duplicative or even conflicting prudential measures.

The Board should, through both its role on the FSB and in this rulemaking, make every effort to avoid outcomes that merely add to insurers' compliance burden without clear systemic benefits, or that create competitive inequality or disadvantage insurers in promulgating its rules under sections 165 and 166. Even if there were no international process pending, these precepts would apply. Minimizing overlap, duplication or conflict in regulatory measures is an important principle in the development of any regulatory framework, and we believe this principle is particularly important when establishing the regulatory framework under sections 165 and 166. We note that in applying the standards set forth in section 165(b)(1), the Board is directed by section 165(b)(2) to give due regard to the principle of national treatment and equality of competitive opportunity, and to take into account the extent to which the Foreign NFC is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the U.S.

V. Intermediate Holding Company Provision

The Proposed Rule would introduce a new requirement for certain FBOs and Foreign NFCs – imposing a U.S. intermediate holding company ("IHC") structure on those institutions. The Proposed Rule would require an FBO with total consolidated assets of $50 billion or more and combined U.S. assets of $10 billion or more (excluding U.S. branch and agency and certain other assets) to form an IHC. The FBO would be required to hold its U.S. operations (other than its U.S. branch and agency operations and certain exempt holdings) through its IHC. The IHC would serve as the focal point for the Board's supervision and regulation of the FBO's U.S. subsidiaries. The Board indicates that the IHC would be an integral part of the Board's approach to the imposition on a consolidated basis of risk-based capital, leverage and liquidity requirements on FBOs. The Board also indicates that the IHC will facilitate the restructuring or resolution of the U.S. subsidiary operations of an FBO by providing one top-tier U.S. legal entity to be resolved or restructured.

The Proposed Rule does not impose a blanket requirement for an IHC on Foreign NFCs designated by the Council. Instead, the Proposed Rule provides that the Board may determine on an individual basis whether to require a Foreign NFC to establish an IHC, based on certain criteria specified in the Proposed Rule. The preamble and the text of the Proposed Rule refer to the imposition of a possible IHC requirement on a Foreign

NFC as being undertaken in accordance with section 167 of the Dodd-Frank Act. In contrast, the preamble discusses the IHC requirement for FBOs as a "supplemental" enhanced standard, presumably based on section 165(b)(1)(B)(iv) of the Dodd-Frank Act.[12]

We note that the provisions of the Proposed Rule relating to the possible imposition of an IHC requirement on a Foreign NFC do not incorporate the criteria set forth in section 167(b)[13] and instead incorporate certain of the criteria specified in sections 113(a) and 113(b).[14] This suggests that the possible imposition of an IHC requirement on a Foreign NFC is actually premised on the authority of section 165(b)(1)(B)(iv) rather than section 167. This is a significant point because an IHC established under the authority of section 167 is subject to specific requirements (such as a source-of-strength requirement) that would not apply to an IHC established under the authority of section 165(b)(1)(B)(iv). We submit that if an IHC requirement is to be proposed for Foreign NFCs, it should be based on the authority of section 165(b)(1)(B)(iv) in conformance with the approach for FBOs and not on the authority of section 167.

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12 77 Fed. Reg. at 76,632.

13 Section 167(a) generally provides that if a nonbank financial company supervised by the Board conducts activities other than those that are determined to be financial in nature or incidental thereto under section 4(k) of the Bank Holding Company Act of 1956, the Board may require such a company to establish and conduct all or a portion of its financial or incidental to financial activities through an intermediate holding company. Section 167(b) provides that the Board shall require a nonbank financial company to establish an intermediate holding company if the Board determines that the establishment of such a company is necessary to
(i) appropriately supervise activities that are determined to be financial in nature or incidental thereto; or
(ii) ensure that supervision by the Board does not extend to the commercial activities of such nonbank financial company.

14 The Proposed Rule provides that the Board will consider the following criteria when determining whether an IHC will be required for a Foreign NFC:
(i) The structure and organization of the U.S. activities and subsidiaries of the Foreign NFC;
(ii) The riskiness, complexity, financial activities, and size of the U.S. activities and subsidiaries of a Foreign NFC, and the interconnectedness of those U.S. activities and subsidiaries with foreign activities and subsidiaries of the [Foreign NFC];
(iii) The extent to which an intermediate holding company would help to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of the Foreign NFC;
(iv) The extent to which the Foreign NFC is subject to prudential standards on a consolidated basis that are administered and enforced by a comparable foreign supervisory authority; and
(v) Any other risk-related factor that the Board determines appropriate.

These criteria generally parallel considerations contained in section 113(a)(1) and section 113(b)(2) of the Dodd-Frank Act.

We are also concerned that the proposed criteria for determining whether a Foreign NFC would be required to establish an IHC largely overlap with the criteria that the Council would use under section 113 to determine whether to designate the Foreign NFC in the first instance, thereby making it likely that any Foreign NFC designated by the Council would *ipso facto* meet the criteria for the IHC requirement. We submit that the criteria and other considerations for any IHC requirement as a supplemental standard under section 165(b)(1) must be based on the criteria and considerations contained in sections 165(b)(2) and (3). Thus, the decision as to whether to impose an IHC requirement on a Foreign NFC must take into account the extent to which the Foreign NFC is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States and must give due regard to competitive considerations as required by section 165(b)(2). The decision as to whether to impose an IHC requirement on a Foreign NFC must also take into account the differences among nonbank financial companies and BHCs and must be adapted in light of the predominant line of business of the Foreign NFC as required by section 165(b)(3). These are important factors that must as a statutory matter be considered in any decision as to whether to impose an IHC requirement on a Foreign NFC. These factors must also be used in tailoring any IHC requirement to the specific situation of the Foreign NFC, in light of the tax, structural, competitive and other impacts of an IHC on a Foreign NFC.

We also have concerns about the potential mode of operation of an IHC requirement. We believe that an IHC requirement, if applied to capture or constrain the use of excess capital and liquidity, could run counter to the basic tenets of coordination and cooperation among the relevant regulators. Moreover, as we discuss in the following sections of this letter, the prudential and early remediation requirements in the Proposed Rule as applied to an IHC are designed for banking organizations and not for the diversity of business models represented by the potential set of Foreign NFCs. The insurance company business model, for example, is fundamentally different from the banking business model. Yet the basic prudential measures contained in the Proposed Rule (and in the Basel Committee capital and liquidity frameworks) are designed for the banking industry.

The Basel Committee itself has no pretentions that its capital and liquidity rules have been designed for insurance companies. The Board should not suffer under any pretention that the Proposed Rule has been designed to reflect the risks of the insurance business model. In any rules ultimately adopted for application to the U.S. activities and subsidiaries of a foreign insurer designated by the Council under section 113(b), the Board should review the prudential and early remediation measures already applicable to the insurer's U.S. activities and subsidiaries under state regulatory regimes. These supervisory and early remediation measures have been specifically designed for insurance companies under state insurance laws. Only if the Board makes detailed findings that the existing state regulatory measures are inadequate to protect against a threat to the financial stability of the United States should the Board consider additional requirements with respect to the Foreign NFC's U.S. activities and subsidiaries. For the reasons discussed above, any such requirements must be specifically designed to take into account the capital structure, riskiness, complexity and activities of the U.S. activities and subsidiaries. As discussed above, the Board should also take into account any prudential measures that have been imposed by the home country supervisor on the U.S. subsidiaries of the Foreign NFC and as required by section 165(b)(2) any prudential measures imposed by home country supervisor on the Foreign NFC on a consolidated basis.

VI. <u>Enhanced Prudential Standards and Early Remediation Requirements</u>

The Proposed Rule provides that a Foreign NFC will be subject to the same enhanced standards as an FBO (with the possible exception of the IHC requirement) unless the Board determines that application of any of the requirements would be inappropriate. Applying bank-centric requirements to a Foreign NFC would be inappropriate and inefficient because it would add inapposite regulations and fail to leverage existing regimes and expertise. Such an approach would, for example, superimpose the Basel regulatory capital and liquidity frameworks on financial institutions like insurers who are not subject to the Basel capital and liquidity frameworks, and for whom such frameworks were never intended.

The provisions of the Proposed Rule relating to the enhanced prudential standards and early remediation requirements have been specifically drafted to reflect the structural and operational elements of the bank-centric operations of an FBO, and therefore it is difficult to understand how these provisions would be applied to the U.S. activities and subsidiaries of a Foreign NFC. For example, the provisions of the Proposed Rule relating to the U.S. branch or agency operations of an FBO have little or no application to a life insurance enterprise that typically acts through separate U.S. life insurance subsidiaries and other financial subsidiaries. We assume that any provision relating to a branch or agency of an FBO would have no potential application to a foreign life insurance company. Even with this assumption, it is particularly difficult to understand how the proposed enhanced prudential standards and early remediation requirements will apply to the U.S. activities and subsidiaries of a Foreign NFC because the standards are in many cases applied based on numerical and structural tests (*e.g.*, $50 billion or more assets in an FBO's IHC) that are specially designed for an FBO, rather than a foreign life insurance enterprise that may have a fundamentally different organizational structure and business model.

The Dodd-Frank Act requires the Board to tailor the application of enhanced prudential standards to Foreign NFCs, and the following comments provide examples of the inappropriateness of the Proposed Rule to Foreign NFCs and the need for tailoring of any Proposed Rule to the actual business model and risks presented by the predominant business lines of the Foreign NFC.

A. Risk-Based Capital Requirements and Leverage Limits

The Proposed Rule would impose "all applicable capital adequacy standards, including minimum risk-based capital and leverage requirements" on an IHC of a Foreign NFC, and require the IHC to "comply with all restrictions associated with applicable capital buffers in the same manner and to the same extent as a [BHC]."[15] If an IHC of an Foreign NFC that is an insurance enterprise is required to comply with bank-centric capital requirements and leverage limits, it will result in inappropriate and ineffective standards being applied to the IHC and indirectly to the U.S. activities and subsidiaries of a Foreign NFC. Instead of requiring an IHC of a Foreign NFC to adhere to bank-centric capital, leverage, and capital plan requirements for its U.S. subsidiaries, the Board must, as required by Title I of the Dodd-Frank Act, tailor application of the enhanced capital and leverage requirements for any IHC based on the specific structure, risk profile, activity mix and predominant line of business of the Foreign NFC.

The Proposed Rule as currently drafted could apparently be read to require a Foreign NFC itself to meet capital adequacy standards on a consolidated basis consistent with the Basel capital framework.[16] Such a requirement is inconsistent with section 102(c) of the Dodd-Frank Act, which as noted above limits the Board's application of enhanced standards to a Foreign NFC's U.S. activities and subsidiaries. Such a requirement also conflicts with the current international regulatory and supervisory framework, which does not apply the Basel capital framework to insurance enterprises. The Board must tailor the application of any capital, leverage or capital plan requirements to Foreign NFCs in order to account for the fundamental differences between insurers and banks. In the insurance context, for example, the proposed capital requirements do not sufficiently account for insurance-related assets such as separate account assets for certain variable insurance products. For these products, inherent risks and performance are driven by fluctuations in interest rates and equity markets, and are borne by policyholders rather than by the insurance company. Similarly, the Board's proposed capital rules provide no weightings for insurance risks, such as exposure to mortality losses or fluctuations in claims reserves.

We are particularly concerned that the IHC of a Foreign NFC could be required to meet a U.S. leverage ratio on a consolidated basis. It would be highly inappropriate to impose a U.S. leverage ratio on the IHC of a Foreign NFC, as the IHC will by definition hold significant amounts of nonbanking assets for which the leverage ratio is not designed, potentially requiring the IHC and the Foreign NFC to maintain capital levels in the U.S. far greater than required to satisfy a risk-based capital requirement. These capital impacts will be particularly severe in the case of U.S. subsidiaries of a Foreign

[15] 77 Fed. Reg. at 76,640; Proposed Rule § 252.212.

[16] Proposed Rule § 225.212(e).

NFC that hold substantial amounts of U.S. government securities, as these assets receive a zero percent risk-weight under the risk-based capital rules but require that four percent of Tier 1 capital to be held against them for purposes of the leverage ratio requirement.[17] We strongly believe that the Board should tailor any application of a leverage ratio requirement to the U.S. activities and subsidiaries of a Foreign NFC so as to avoid the imposition of disproportionate and unnecessarily punitive leverage capital requirements on these entities. In particular, to the extent any leverage ratio is applied to the U.S. activities and subsidiaries of a Foreign NFC, the Board should exclude from the ratio any asset considered a "high quality liquid asset" for purposes of the Basel III Liquidity Coverage Ratio framework.[18]

Any enhanced capital requirements for Foreign NFCs must also take appropriate recognition of the difficulties associated with gathering and aggregating the data necessary for the Foreign NFC to report its capital condition to the Board based on bank-centric metrics. Foreign NFCs currently do not file the FR Y-9C series of reports or other reports that the Board may require in order to determine the capital condition of the NFC's U.S. subsidiaries. Foreign NFCs should not be subject to capital and leverage requirements that are not related to their actual structures and mixes of activities, and should similarly not be required to aggregate and report data in support of such capital requirements when the data would be difficult to collect and would yield misleading and inaccurate information about the capital condition of the Foreign NFC.

For additional analysis, we refer the Board to the Joint Comment Letter, in which we provided extensive comments on the inappropriate application of bank-centric capital and leverage requirements to U.S. nonbank financial companies in the December 2011 Proposal, and the need for the Board to consider the differences among nonbank financial companies and banking organizations and adapt any capital and leverage requirements to the predominant line of business of a nonbank financial company.[19] We also refer the Board to joint comments submitted by the Roundtable and the American Bankers Association (the "ABA") in response to the Federal banking agencies' proposed rules to substantially revise the capital framework for U.S. banking organizations and implement the Basel III capital framework in the United States.[20] In that letter, we provided extensive comments on the problems associated with applying a bank-centric capital framework to insurance companies

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17 This would be a particular problem in the case of a broker-dealer subsidiary of a Foreign NFC, as broker-dealers often hold substantial amounts of U.S. government securities in inventory as part of their normal-course dealing activities.

18 Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* 7-8 (Jan. 2013), *available at* http://www.bis.org/publ/bcbs238.htm.

19 *See* note 5 *supra* and accompanying text.

20 *See* Letter from the Roundtable and the ABA, to the Board (Oct. 22, 2012), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs12/FSRSLHCCapitalLetter.pdf.

and the lack of sufficient tailoring in the proposed capital requirements for assets and exposures held by insurance companies.

B. Liquidity

The Proposed Rule would impose liquidity and liquidity risk management requirements on Foreign NFCs that are similar to the December 2011 Proposal, including liquidity stress testing requirements, requirements to maintain liquid assets sufficient to meet projected net cash flows under the stress tests, and to generate comprehensive cash flow projections, a requirement to establish and monitor liquidity risk tolerance, and a requirement to maintain contingency funding plans where normal sources of funding may not be available. The Proposed Rule in certain instances appears to be even more prescriptive than the December 2011 Proposal, in that it would require an FBO with combined U.S. assets of $50 billion or more to maintain a specified liquidity buffer for its U.S. branch or agency network and a separate buffer for its IHC, and provides for a series of detailed and prescriptive requirements for calculating the amount of the required buffer.[21]

Any liquidity and liquidity risk management requirements for the U.S. operations and subsidiaries of a Foreign NFC must take into account the significant differences in the liquidity profiles of insurers and banking organizations. Liquidity risk management by Foreign NFCs must be informed by the specific mixes of assets and liabilities on their balance sheets, as well as the liquidity risks they actually face. We are concerned that the Proposed Rule appears to reflect the incorrect assumption that a Foreign NFC that is an insurance enterprise will face the same or similar liquidity risks as a Large BHC. Insurance companies, for example, have predominantly long-dated (as in the case of a life insurance policy), rather than short-dated (as in the case of a bank deposit) liabilities on their balance sheets. The Proposed Rule, however, make few if any provisions for these differences. In order to properly account for these differences, the Board's separate rulemaking process should make explicit provision for a principles-based approach to liquidity and liquidity risk management for Foreign NFCs that are insurance enterprises. A Foreign NFC will already have policies, procedures and risk management frameworks in place relating to liquidity that have been tailored (based on long experience) to their actual risk profile and mix of activities. The Board's separate rulemaking process for Foreign NFCs should take appropriate recognition and encourage the use of these existing frameworks.

We are also concerned that the provisions of the Proposed Rule relating to liquidity risk and liquidity risk management are so detailed and prescriptive as to risk impeding directors' proper discharge of their oversight duties and blur the distinction between the proper oversight role of the Foreign NFC's board of directors and

[21] *See* Proposed Rule § 225.227.

management's responsibilities for day-to-day U.S. operations of the Foreign NFC. The Board should adopt a less prescriptive approach for a Foreign NFC, one that recognizes the different business models, different mixes of financial activities, and different asset and liability profiles of Foreign NFCs will directly affect the nature and scope of the liquidity risks and appropriate liquidity risk management processes for these firms.

C. Single-Counterparty Credit Limits

Under Subpart N of the Proposed Rule, a Foreign NFC's U.S. operations would be subject to a single-counterparty credit limit ("SCCL") on aggregate exposure to unaffiliated counterparties. Similar to the December 2011 Proposal, the Proposed Rule would impose a general net credit exposure limit of 25% of consolidated capital stock and surplus, and a more stringent limit on counterparty exposures between "major" companies, which would likely include exposures between a Foreign NFC and certain Large BHCs.[22] The Proposed Rule would exempt certain exposures from the limit, including claims fully guaranteed as to principal and interest by the United States and its agencies, and Fannie Mae and Freddie Mac while under government conservatorship. Claims fully guaranteed as to principal and interest by a Foreign NFC's home country government would also be exempt from the limit.

The SCCL will present particular issues for a Foreign NFC that is predominantly an insurance enterprise. For example, application of the SCCL to a Foreign NFC that is an insurance enterprise may limit the NFC's ability to adequately and appropriately match the duration of its assets and liabilities. Because of the long-dated nature of insurance liabilities, an insurer must be able to find and to hold long-dated assets to match those liabilities. Imposing an across-the-board limit could hinder a Foreign NFC from holding the types of assets necessary to insure payments to its policyholders, thereby increasing, rather than decreasing, the risk posed by the institution to the financial marketplace.

D. Risk Management

The Proposed Rule would impose risk management requirements on Foreign NFCs substantially similar to the December 2011 Proposal. Under the Proposed Rule, a Foreign NFC would be required to have a U.S. risk committee with oversight over U.S. risk management practices using a risk management framework that is commensurate with the capital structure, risk profile, complexity, activities and size of the entity's combined U.S. operations and consistent with the entity's enterprise-wide risk management policies. The Foreign NFC's framework would be required to include

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22 Although the Board proposed in the December 2011 Proposal to set the more stringent limit at 10 percent. numerous commenters objected to this approach. The Board has chosen to retain a more stringent limit for exposures between major firms. but is re-evaluating the precise level of this limit.

policies, procedures and systems for monitoring the risk of the Foreign NFC's U.S. operations. A Foreign NFC's U.S. risk committee could be housed either in its head office board of directors, or in the board of directors of its IHC. If housed in the head office board of directors, the U.S. risk committee could be either a standalone committee or part of an enterprise-wide risk committee.

It is important for the Board to remain cognizant of the fact that foreign and domestic nonbank financial companies will often face risks that are distinct from risks facing BHCs, insurance companies in particular. For example, insurance companies face risks that are largely uncorrelated with the risks arising from traditional banking activities, such as those associated with commercial and consumer lending and deposit-taking. Insurance risks also exhibit a lower level of *intra*-correlation than risks facing banking organizations. Given that the risks facing Foreign NFCs frequently differ from those facing FBOs, it is unsurprising that many NFCs, including Foreign NFCs, have adopted risk management frameworks suitable to their actual risks. These insurance enterprises often face risks that are less correlated than those at their banking counterparts, they have designed risk management frameworks to reflect this fact. One element of an effective enterprise-wide risk management framework for a Foreign NFC might include the very diversity of the different financial activities, including insurance activities, in which the NFC is engaged.

Similarly, the responsibilities the Board assigns to the U.S. risk committee and the U.S. chief risk officer do not take into account how insurance enterprises function and are regulated. State insurance regulation already requires close monitoring of an insurer's solvency, and insurance regulators must approve new products offered by insurance companies. Any risk management framework applied to the U.S. activities and subsidiaries of a Foreign NFC that is an insurance enterprise must be tailored to the actual structure of and risks facing that enterprise.

E. Stress Testing

Under the Subsection P of the Proposed Rule, a Foreign NFC would be subject to Board- and company-run stress testing requirements with respect to its U.S. operations. As with the other enhanced standards, the Board should afford proper recognition to the differences between Foreign NFCs and FBOs, and should tailor the stress testing requirements to the capital structure, risk profile, complexity, activities and size of the particular Foreign NFC. We encourage the Board, as it committed to do with its stress-testing rules for domestic NFCs, to tailor stress testing requirements to the characteristics of the individual Foreign NFC.

We note in particular that it is misguided to apply a bank-centric stress testing framework to firms which will likely be fundamentally different from FBOs, particularly when the testing results will result in the application of additional restrictions. Any stress testing framework for Foreign NFCs should reflect assumptions and methodologies appropriate to the risks that a Foreign NFC actually faces, such as mortality or catastrophe risk. Additionally, any stress testing framework should be appropriately tailored to the business model and capital structure of the Foreign NFC. As proposed, the Proposed Rule would, for example, require a Foreign NFC that is an insurance enterprise to stress test against losses in its loan portfolio, a metric that is highly relevant to a banking organization, but far less so to an insurance enterprise. The set of data and information required for stress testing should be tailored to the specific NFC in order for the Board to accurately gauge the financial health of the Foreign NFC's U.S. activities and subsidiaries, and also to allow these subsidiaries to continue to conduct business in the most prudent manner possible without having to worry about meeting inappropriate standards.

F. Debt-to-Equity Limit

Section 165(j) of the Dodd-Frank Act provides that the Board must require a nonbank financial company to maintain a debt-to-equity ratio of no more than 15-to-1 upon a determination by the Council 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 Council makes a finding that the company poses a grave threat to the financial stability of the United States. Subsection Q of the Proposed Rule provides that for purposes of this requirement, "debt" and "equity" have the same meaning as "total liabilities" and "total equity capital," as reported by an IHC on the FR Y-9C or other reporting form prescribed by the Board. These definitions in effect substitute "total liabilities" for the statutory term "debt."

We submit that although section 165(j)(3) of the Dodd-Frank Act authorizes the Board to promulgate regulations "to establish procedures and timelines for complying with the requirements of" subsection (j), it does not provide the Board authority to rewrite the substantive requirements of subsection (j). Section 165(j) provides for a test based on "debt," not on "total liabilities," and the substitution of "total liabilities" for debt in the ratio calculation does not take account of the differences in liability structure between Foreign NFCs and FBOs, especially in the case of a Foreign NFC that is an insurance enterprise. For example, under statutory 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 represent a significant part of the total liabilities of an insurer and are not comparable to reserves held by banking organizations, but nevertheless would be included in the definition of "debt" for purposes of the limit. Likewise, insurance enterprises often maintain significant separate account balances that are reflected as assets and offsetting liabilities on their balance sheets. This category of assets and liabilities is unique to insurers and is not comparable to any category of asset or liability for banking organizations. Separate account liabilities reflect interest rate and equity market risks that are borne by policyholders, which are offset by related separate account asset balances for accounting purposes. Similarly, insurance reserves do not reflect the same liquidity mismatch as do banking liabilities (*e.g.*, deposit reserves), as industry practice is to match these (generally long-term) policyholder liabilities with assets of similar duration. Therefore, neither of these liabilities presents significant leverage or liquidity risk.

Whatever arguments exist in support of using total liabilities as a proxy for debt in the case of a banking organization, it would clearly be inappropriate to substitute "total liabilities" for "debt" in the case of a Foreign NFC that is an insurance enterprise. Such an approach is clearly not justified and reflects a failure to take into account the fundamental differences between insurance enterprises and banking organizations.

G. Early Remediation

Under Subsection R of the Proposed Rule, a Foreign NFC's U.S. operations, including any IHC, would be subject to a bank-centric early remediation framework based on the Prompt Corrective Action provisions of the Federal Deposit Insurance Act. The early remediation "triggers" are highly bank-centric, and would be inappropriate for application to the U.S. operations of a foreign insurance NFC. Given the bank-centric nature of the early remediation triggers, there is also the risk that the framework could prevent a Foreign NFC from taking necessary actions to mitigate its financial distress, such as acquiring assets to hedge outstanding risks or engaging in activities that enhance the company's overall capital and liquidity position.

In particular, the Board should not impose remediation triggers on the U.S. operations of a foreign insurer based on bank-centric risk-based capital or leverage ratios. The U.S. operations of a Foreign NFC that is an insurance company will likely have significantly different balance sheets, risk profiles, and capital and liquidity needs than banking organizations. Subjecting Foreign NFCs to automatic triggers that are tied to bank-centric regulatory capital and leverage standards could result in unwarranted early remediation actions taken against such companies.

Any early remediation framework for Foreign NFCs should be based on the specially designed risk-based capital rules applicable to U.S. insurers. Risk-based capital rules for insurers were developed at the same time as the PCA rules for insured depository institutions. The states have enacted risk-based capital laws requiring each insurer to file a uniform annual risk-based capital report, the form of which is maintained by the National Association of Insurance Commissioners. 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). We submit that any early remediation framework potentially applicable to the U.S. activities and subsidiaries of a foreign insurance enterprise must take these existing early remediation requirements into account.

VII. Conclusion

We thank the Board for the opportunity to comment. If you have any questions, please feel free to contact me or Richard Foster at (202) 589-2424.

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