ACLI
Financial Security...for Life.

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

April 24, 2013

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

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

Dear Chairman Bernanke:

These comments are submitted on behalf of the American Council of Life Insurers (the "ACLI"). The ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. We appreciate the opportunity to submit comments on the Board's notice of proposed rulemaking implementing enhanced prudential standards and early remediation requirements for foreign banking organizations and foreign nonbank financial companies (the "Proposed Rule").[1] The Proposed Rule raises important issues both for foreign banking organizations ("FBOs") and for foreign nonbank financial companies ("Foreign NFCs"). The comments of the ACLI in this letter focus exclusively on the aspects of the Proposed Rule relating to Foreign NFCs.

I. Introduction

A. Overall Approach in the Proposed Rule

The Proposed Rule would implement the enhanced prudential standards and early remediation requirements of Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") for (i) FBOs with $50 billion or more in total consolidated assets and (ii) Foreign NFCs designated as systemically important by the Financial Stability Oversight Council (the "FSOC") pursuant to Title I of the Dodd-Frank Act. The Proposed Rule follows a notice of proposed rulemaking issued by the Board in December 2011 (the "Domestic Proposal"), proposing to apply enhanced prudential standards and early remediation requirements to U.S. bank holding companies ("BHCs") with $50 billion or more in total consolidated assets ("Large BHCs") and U.S. nonbank financial companies designated as systemically important by the FSOC ("Domestic NFCs").[2]

The Proposed Rule generally adopts the standards set forth in the Domestic Proposal for Large BHCs. This is presumably because the Proposed Rule is designed expressly with FBOs in mind just as the

[1] Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 *Fed. Reg.* 76,628 (Dec. 28, 2012).
[2] Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 *Fed. Reg.* 594 (Jan. 5, 2012).

Domestic Proposal was designed with Large BHCs in mind.[3] The preamble to the Proposed Rule explains that the proposal broadly adopts the standards set forth in the Domestic Proposal "to ensure equality of competitive opportunity, as modified appropriately for foreign banking institutions."[4] As a consequence, the Proposed Rule is bank-centric in design just as the Domestic Proposal was. The Proposed Rule makes certain modifications in its proposed standards, but all of these modifications are expressly designed to reflect the structural and operational aspects of FBO operations in the United States. Even with these modifications, the Proposed Rule remains a bank-centric rule. The treatment of Foreign NFCs is a mere appendage to the Proposed Rule.

The preamble to the Proposed Rule provides only a high-level explanation of provisions of the Proposed Rule as they relate to Foreign NFCs. The preamble, citing Section 165(a)(2) of the Dodd-Frank Act, notes that in applying the proposed prudential standards to Foreign NFCs, the Board expects to tailor the application of the standards to different companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and any other risk factors that the Board deems appropriate. The preamble, citing Section 165(b)(2) of the Dodd-Frank Act, notes that the Board will review whether the enhanced prudential standards as applied to particular Foreign NFCs would give due regard to the principle of national treatment and competitive equality and will take into account the extent to which the foreign company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

We note that in addition to the provisions of Section 165, Section 102(c) of the Dodd-Frank Act expressly provides that for purposes of the application of subtitles A and C (other than Section 113(b)) with respect to a Foreign NFC, references in Title I to "company" or "subsidiary" include only the United States activities and subsidiaries of such foreign company, except as otherwise provided. Accordingly, we presume that in applying any prudential standards under Section 165 or remediation requirements under Section 166 the Board will limit their application to the United States activities and subsidiaries of any Foreign NFC that might be designated by the FSOC.

B. General Observations Relating to the Approach in the Proposed Rule for Foreign Nonbank Financial Companies

As we noted in our comments on the Domestic Proposal,[5] and in other comments to the Board,[6] it is the firm belief of the ACLI that traditional core life insurance activities do not present a systemic risk to the financial stability of the United States. As we have previously discussed, the core business activity of most life insurers in the United States, including those owned by foreign insurance groups, involves providing policyholder coverage for long-term risks, and matching these long-term liabilities with assets appropriate to ensure that these liabilities are met. This is a fundamentally different business model than financial institutions which depend on short-term, on-demand funding, and are much more susceptible to runs on their liabilities during periods of stress. Core life insurance activities do not give rise to high interconnectedness with other financial institutions, and life insurers are highly regulated in ways that decrease the risk they pose to the financial system. In addition, the insurance regulatory system provides an established process for the orderly rehabilitation or wind-down of impaired life insurers. This wind-down process, combined with the illiquid nature of insurance company liabilities, prevents "fire sale" liquidations that can spread contagion to otherwise healthy firms.

---

[3] 77 *Fed. Reg.* at 597.

[4] 77 *Fed. Reg.* at 76,632.

[5] *See* Letter from the ACLI to the Board (Apr. 25, 2012), *available at* http://www.federalreserve.gov/SECRS/2012/May/20120518/R-1438/R-1438_042512_107212_504336335598_1.pdf.

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

These factors are relevant not only to the determination by the FSOC as to whether a domestic or foreign life insurance company should be designated under Section 113 of the Dodd-Frank Act, but also to the application of enhanced standards under Section 165 by the Board in the event that a domestic or foreign life insurance company were to be designated by the FSOC under Section 113. Under the provisions of Section 165(b)(3) of the Dodd-Frank Act in prescribing prudential standards, the Board is *required* to take into account the differences between nonbank financial companies and bank holding companies and must adapt the standards as appropriate in light of the predominant line of business of any nonbank financial company.

The Proposed Rule raises fundamental questions relating to the treatment of the U.S. activities and subsidiaries of foreign insurance groups. First, the Proposed Rule raises important questions as to how and to what extent the Board will tailor application of the enhanced standards to the U.S. activities and subsidiaries of a Foreign NFC that is a life insurer in light of the fact that its U.S. insurance activities and operations will differ fundamentally in capital structure, risk profile, complexity, size and mix of activities from a Large BHC or an FBO. Although the Board states in the preamble to the Proposed Rule that it "expects" to tailor application of the enhanced standards to a Foreign NFC, the Proposed Rule by its terms is highly bank-centric in structure and content, and would apply highly bank-centric requirements to the U.S. operations of a Foreign NFC that is a life insurer. Consistent with our comments on the Domestic Proposal, we maintain that it is essential for the Board to tailor the application of any proposed standards to the U.S. activities and subsidiaries of a Foreign NFC that is a life insurer in a way that accounts for the fundamental differences between insurance companies and banking organizations.

Second, the Proposed Rule raises fundamental questions relating to the international impact of the approach in the Proposed Rule: *i.e.*, how the Proposed Rule will impact cross-border regulation of global life insurance firms, both foreign life insurers with activities or subsidiaries in the United States and U.S. life insurance companies with operations in foreign countries. As we discuss below, there are ongoing international supervisory initiatives relating to insurance, including initiatives specifically relating to enhanced supervision of global systemically important insurers ("G-SIIs"). These enhanced measures would be implemented by the relevant national insurance authorities in their individual jurisdictions. The ultimate outcome of any rulemaking process under Section 165(b) with respect to Foreign NFCs that are insurers must be harmonized to the fullest extent possible with the ultimate outcome of these international supervisory and home country efforts.

C. Appropriate Course of Action for Rulemaking With Respect to Foreign Nonbank Financial Companies

As noted above, the Proposed Rule is specifically designed for application to FBOs. Its provisions are intended to reflect the structural and operational diversity of FBO operations in the United States. As drafted, most of the provisions of the Proposed Rule have potential relevance only as applied to an FBO. The Proposed Rule provides no indication as to how its provisions would be applied to a Foreign NFC other than the general statement that all of its provisions (other than possibly the intermediate holding company ("IHC") provision) would apply to a Foreign NFC unless the Board determines that the application of a particular provision would not be "appropriate." The Proposed Rule and the preamble provide no guidance as to how the Board would determine whether a particular provision (or indeed any provision) would be "inappropriate" for application to a Foreign NFC. There is no indication of what process or what considerations the Board would use in making the determination. Because the Proposed Rule is so obviously designed for application to FBOs and provides virtually no guidance as to its application to Foreign NFCs, prospective Foreign NFCs are not provided a fair or adequate basis on which to comment on the Proposed Rule.[7]

[7] We note that no NFCs have yet been designated by the FSOC. Hence, the parties with the greatest interest in this rulemaking have not yet been determined. In effect, undetermined parties are being asked to comment on undetermined rules.

Accordingly, we submit that the Board must either (i) re-propose the Proposed Rule in a form that provides reasonable specificity as to how the Board proposes to apply the prudential standards to Foreign NFCs or (ii) exclude Foreign NFCs from the Proposed Rule and conduct a separate rulemaking to establish an approach for standards and requirements to be applied to Foreign NFCs that do not suffer from the obvious deficiency of having been designed specifically to reflect the structural and operational elements of FBO operations. The subsequent comments in this letter are intended to provide additional support for the request that the Board re-propose the Proposed Rule to provide adequate guidance as to how it would be tailored for application to Foreign NFCs or exclude Foreign NFCs from the Proposed Rule and conduct a separate rulemaking for Foreign NFCs.

II. Required Tailoring for Foreign Nonbank Financial Companies

The Proposed Rule provides that a Foreign NFC would generally be subject to the same enhanced prudential standards and early remediation requirements as an FBO (with the possible exception of the IHC provision), unless the Board determines that application of a particular standard or requirement would be inappropriate.[8] As noted above, the Board states in the preamble to the Proposed Rule that in applying the enhanced prudential standards to a Foreign NFC, it expects to tailor the application of the standards to different companies on an individual basis, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factor as appropriate. The Board also states that it would review whether applying the enhanced standards to a particular Foreign NFCs gives due regard to the principle of national treatment and equality of competitive opportunity, and would 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. Finally, the Board states that it expects to issue an order providing clarity on how the enhanced prudential standards would apply to a Foreign NFC once it is designated by the FSOC.

We strongly support the Board's statements of its expectation to tailor application of the enhanced standards to Foreign NFCs, but we submit that it must be more than an *expectation*. It is a *requirement*. Section 165(b)(3) of the Dodd-Frank Act requires the Board to take into account differences between and among nonbank financial companies and BHCs, and to adapt the required standards as appropriate to the predominant line of business of the nonbank financial company. We submit that the Board must engage in tailoring consistent with the requirements of Section 165(b)(3) with respect to any Foreign NFC that may be designated by the FSOC.

We also submit that the Board must tailor application of the standards in particular to avoid the imposition of "bank-centric" enhanced standards on the U.S. activities and subsidiaries of a Foreign NFC that is a life insurer. Application of the bank-centric standards to any Foreign NFC that is a life insurer will have a significant adverse effect on that firm, and it is imperative that the Board avoid imposing standards that do not account for the significant differences in capital structure and risk profile as between insurance companies and banking organizations. While we offer examples in this letter of how various of the proposed standards might be tailored to a Foreign NFC that is a life insurer, the absence of comments on any specific provision should not be taken as agreement that it would be appropriate to impose that provision without tailoring. To the contrary, we submit that the Board must tailor application of each enhanced standard to a Foreign NFC that is a life insurer as required by Section 165(b)(3) of the Dodd-Frank Act.

III. International Considerations

We also submit that it is imperative for the Board's tailoring process for a Foreign NFC that is a life insurer to take into account ongoing international initiatives relating to the regulation and supervision of global insurance groups. Under the purview of the Financial Stability Board (the "FSB"), the International Association of Insurance Supervisors (the "IAIS") has promulgated both a designation framework and

[8] *See 77 Fed. Reg.* 76,679 (to be codified at 12 CFR 225.2(d)(2)).

proposed policy measures for G-SIIs.[9] The IAIS has indicated that it intends to recommend the first group of insurance companies to the FSB for possible designation in the first half of 2013. The IAIS has also proposed for comment a set of policy measures that the relevant national insurance regulatory authorities may apply to any insurance company designated as a G-SII. The proposed policy measures relate to enhanced supervision, effective resolution, and higher loss absorption capacity. The IAIS is currently reviewing the substantial comments received on its proposed policy measures.

Although the international processes of the FSB and the IAIS relating to G-SIIs are independent from the FSOC and Board processes relating to Foreign NFCs, the pendency of these processes creates the possibility of overlapping, duplicative or inconsistent prudential measures. As indicated above, we believe that the ultimate outcome of any prudential rulemaking process under Section 165(b) with respect to Foreign NFCs that are insurers must be harmonized to the fullest extent possible with the ultimate outcome of these international and home country supervisory initiatives. This outcome is in fact mandated by the language of Section 165(b)(2), which provides that in applying any enhanced standards to a Foreign NFC, the Board must take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States. Section 165(b)(2) likewise mandates that the Board should give due regard to the principle of national treatment and equality of competitive opportunity in applying any standards under Section 165 to a Foreign NFC.

In the event that a foreign life insurer is designated as a Foreign NFC by the FSOC and as a G-SII by the FSB, the Board should coordinate with the NFC's home country supervisor in developing and applying any prudential standards to the U.S. activities and operations of the NFC. In the unlikely event that a Foreign NFC is designated by the FSOC without being designated a G-SII by the FSB, the Board would still need to coordinate with the NFC's home country supervisor in developing and applying any prudential standards to the U.S. activities and subsidiaries of the Foreign NFC.

We are concerned that lack of coordination between the Board and home country supervisors may lead to negative impacts for both domestic and foreign life insurers and the financial system as a whole. The Board plays a leading role in the international supervisory community, and therefore supervisors in other jurisdictions may respond to action by the Board with respect to the regulation of the U.S. activities and operations of foreign financial institutions doing business in the United States. Thus, for example, if the Board were to impose standards on the U.S. activities and operations of a Foreign NFC that are not in harmony with developing international standards, foreign supervisors might be encouraged to take action against U.S. life insurers doing business in those jurisdictions.

We are particularly concerned that the "ring-fencing" of the assets of foreign insurance firms doing business in the United States could set a dangerous precedent for global coordination on the development of a robust and effective international regulatory framework for global insurance firms. With respect to life insurers, for example, ring-fencing would negatively impact the ability of the affected insurer to effectively deploy capital, and because of the benefits of risk pooling in insurance, could in fact significantly increase the systemic risks of the insurer. State insurance regulation in the U.S. already provides a well-developed system that is designed to maintain and assure the safety and soundness of U.S. life insurance companies and that specifically addresses capital and loss absorption capacity. The existing state insurance regulatory system has the marked advantage over the bank-centric approach reflected in the Proposed Rule that it is specifically designed to address the risks of life insurance activities, which are fundamentally different than the risks of banking organizations. Among the distinct elements of the state insurance regulatory system are stringent regulations for the determination of insurance reserves, with mortality and/or morbidity tables with explicit margins (cushions) for

---

[9] IAIS, *Global Systemically Important Insurers: Proposed Assessment Methodology* (May 31, 2012), *available at* www.iaisweb.org/view/element_href.cfm?src=1/15384.pdf; IAIS, *Global Systemically Important Insurers: Proposed Policy Measures* (Oct. 17, 2012), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/16647.pdf.

conservatism that must be used in the calculation of minimum reserves. Likewise, the state insurance regulatory system under the auspices of the National Association of Insurance Commissioners (the "NAIC") has implemented a well-refined risk-based capital regime that addresses the full variety of risks that a life insurance company might confront.

As a macroprudential matter, ring-fencing could lead to regulatory and supervisory "balkanization" of standards for affected life insurers, and would negatively impact efforts to develop effective cross-border recovery and resolution regimes already under consideration by the IAIS. While the Board will undoubtedly receive extensive comments about the negative impacts of the Proposed Rule on the cross-border regulation of internationally active FBOs, these issues are of equal concern to foreign life insurers with U.S. operations.

IV. Comments on Specific Prudential Provisions in the Proposed Rule

Because the provisions of the Proposed Rule are specifically drafted to reflect the structural and operational elements of the bank-centric operations of an FBO, it is difficult to project how these provisions would be applied to the U.S. activities and subsidiaries of a Foreign NFC. For example, the various provisions relating to the U.S. branch or agency operations of an FBO will have little or no application to a foreign life insurance enterprise that typically acts through separate U.S. life insurance subsidiaries and other financial subsidiaries. We assume for purposes of this comment letter 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, the application of the provisions in the Proposed Rule to the U.S. activities and subsidiaries of a foreign life insurance company is difficult to project and hence in the abstract to provide informed comments on.

The Federal Register notice for the Proposed Rule notes that the Proposed rule broadly adopts the standards proposed for large bank holding companies and nonbank financial companies in the Domestic Proposal.[10] By letter, dated April 25, 2012, we offered detailed comments on the application of the Domestic Proposal to nonbank financial companies and we hereby incorporate by reference the comments contained in our April 25, 2012 letter with respect to the Proposed Rule.[11] The following comments are thus intended only as examples of how the bank-centric provisions in the Proposed Rule would be inappropriate for application to the U.S. activities and subsidiaries of a hypothetical Foreign NFC (no such entity having yet been designated by the FSOC).

A. Intermediate Holding Company Requirement

The Proposed Rule would require an FBO with total consolidated assets of $50 billion and combined U.S. assets of $10 billion or more (excluding U.S. branch and agency and certain other exempt assets) to form an IHC. The FBO would be required to hold its U.S. operations (other than the U.S. branch and agency operations and certain exempt investments) through the IHC, which would serve as a focal point for the Board's supervision and regulation of the FBO's U.S. subsidiaries. The Proposed Rule would not require a Foreign NFC to establish an IHC, but would permit the Board to require any individual 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 as a "supplemental" enhanced standard, presumably based on Section 165(b)(1)(B)(iv) of the Dodd-Frank Act. 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) and instead incorporate certain criteria specified in Section 113(b). This suggests that the possible imposition of an IHC requirement on a Foreign NFC is actually premised on the authority of

---

[10] *77 Fed Reg.* at 76632.

[11] See note 5 *supra*.

Section 165(b)(1)(B)(iv) rather than Section 167. We believe that this is an important distinction 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 be applicable to an IHC established under the authority of Section 165(b)(1)(B)(iv). We submit that if an IHC requirement is to be imposed on any Foreign NFC, it should be based on the authority of Section 165(b)(1)(B)(iv) and not on the authority of Section 167.

We are also concerned that the proposed criteria contained in the Proposed Rule for determining whether a Foreign NFC would be required to establish an IHC are largely subsumed in the criteria that the FSOC 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 will *ipso facto* meet the criteria for the IHC requirement. The considerations for the possible imposition of an IHC requirement on a specific Foreign NFC under Section 165(b)(1) must be based on all the criteria and considerations contained in Sections 165(b)(2) and (3) and the other Sections of Title I of the Dodd-Frank Act. In addition, if imposed, the requirement for an IHC must be tailored to the case of the individual Foreign NFC based on these same criteria and considerations. Thus, the decision whether to impose an IHC requirement on a particular 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 whether to impose an IHC requirement on a Foreign NFC must also take into account the differences among nonbank financial companies and BHCs, including whether the nonbank financial company owns an insured depository institution and the nonfinancial activities and affiliations of the nonbank financial company. The decision whether to impose an IHC requirement must also take into account and be adapted in light of the predominant line of business of the Foreign NFC, including assets under management or other activities for which particular standards may not be appropriate, as required by Section 165(b)(3). Moreover, under Section 161(a), the Board must consider to the fullest extent possible the use of (i) existing reports and supervisory information that a nonbank financial company or subsidiary is required to provide to other federal or state regulatory agencies and (ii) information that is otherwise obtainable from federal or state regulatory agencies. Similarly, Section 169 requires the Board to take appropriate action to avoid imposing requirements under Subtitle A of Title I that are duplicative of requirements applicable to nonbank financial companies under other provisions of law.

Each of these statutory directives must be considered in the decision whether to impose an IHC requirement on a Foreign NFC. As applied to a Foreign NFC that is predominantly engaged in insurance activities through subsidiaries in the United States, this means considering the full range of factors that relate to the structure and operations of the U.S. subsidiaries of the Foreign NFC, such as the fact that the U.S. insurance subsidiaries of a Foreign NFC are already subject to extensive state insurance regulation and supervision. As we discuss in other sections of this letter (and as we previously discussed in our April 25, 2012 comment letter), the U.S. insurance subsidiaries of a Foreign NFC are subject to state insurance laws and regulations, covering such areas as capital, reserving, accounting, financial reporting, risk management and, if necessary, early remediation and resolution. These state regulatory requirements have been designed by the state regulatory authorities to address the specific risks of insurance activities and as such are entitled to significant weight in the various determinations to be made under Section 165 with respect to both Domestic NFCs and Foreign NFCs. Unless the Board makes a specific and detailed determination that the state insurance regulatory regimes are inadequate to address the concerns underlying section 165, the Board should defer to these requirements and should not layer on additional or duplicative requirements.

In addition to the state insurance law requirements applicable to insurance companies, each state also has a holding company law that applies to a controlled insurance company and any entity that controls an insurance company. The state holding company law typically includes the following requirements: (1) required approval by the controlled insurer's domestic state insurance regulator of the acquisition of control of the insurer; (2) an annual holding company registration statement to be filed by the controlled insurer with its domestic state insurance regulator disclosing, among other things, the identity of all of its affiliates, information about the insurer's ultimate controlling person, disclosure of affiliate transactions to which the insurer is a party, and audited financial statements, annual reports to shareholders and proxy materials for its ultimate controlling person; (3) standards for all affiliate transactions to which the controlled insurer is a party and prior notice of certain material affiliate transactions to the insurer's domestic state insurance regulator; and (4) notice of controlled insurer shareholder dividends to, and prior approval of "extraordinary" (large) dividends by, the insurer's domestic state insurance regulator. Many states have also enacted an amendment to their insurance holding company law that requires that the ultimate controlling person of every controlled insurer subject to registration also file an annual enterprise risk report in which it analyzes the material risks within the insurance holding company system that could pose enterprise risk to the insurer. The Board must take into account these existing state regulatory regimes for insurance companies and insurance holding companies in making any decision to impose an IHC requirement on a Foreign NFC and must avoid imposing duplicative or overlapping requirements on a Foreign NFC. This outcome is required by the language of Section 161(a), Section 165(b), and Section 169.

In addition to state regulatory considerations, other business and tax considerations are important determinants of the corporate structure that a Foreign NFC might use to hold its U.S. subsidiaries. Foreign NFCs hold their U.S. subsidiaries through a variety of structures, reflecting differing considerations among Foreign NFCs. These factors, in some cases specific to the individual Foreign NFC, must be taken into account in determining whether to impose an IHC requirement on a Foreign NFC. For example, the upfront and future tax costs arising from any restructuring of the U.S. operations of a Foreign NFC may be very substantial and must be weighed as one of the important factors in any decision to require a Foreign NFC to establish an IHC that deviates from its current structure for holding its U.S. operations.

If, after weighing all the relevant factors, the Board nonetheless determines that a particular Foreign NFC should establish an IHC pursuant to Section 165, we submit that the operational details of the IHC requirement must be tailored to the specific facts of the Foreign NFC to the fullest extent possible. If the Foreign NFC already has an intermediate U.S. holding company or companies, the Foreign NFC should be allowed to use that holding company or holding companies in lieu of establishing an additional IHC. This will avoid the significant tax, legal and regulatory issues that will arise if a corporate restructuring is required to constitute a new IHC under the Proposed Rule. The scope of application of an IHC requirement should also be tailored. For example, the scope of entities required to be held by an IHC should be limited to U.S. entities that would be required to be consolidated into the IHC for financial reporting purposes if the relevant ownership interest were held by the IHC. Likewise, the specific IHC requirement for an individual Foreign NFC should not necessarily require that joint ventures, minority interests or other similar investments be moved under the IHC. Finally, given the legal, tax, regulatory, contractual and other complexities that will inevitably arise from any restructuring of the U.S. operations of a Foreign NFC to implement an IHC requirement, the Foreign NFC should be allowed at least three years to comply with such a requirement.

We offer the following additional comments on the other proposed standards in the Proposed Rule whether or not an IHC is required for the Foreign NFC.

B. Risk-Based Capital and Leverage

The risk-based capital and leverage requirements in the Proposed Rule are a prime example of the exclusively bank-centric approach taken in the Proposed Rule. The Proposed Rule provides that regardless of whether it controls a insured depository institution, a Foreign NFC's IHC would be required to calculate and meet all applicable capital adequacy standards, including minimum risk-based capital and leverage requirements, and comply with all restrictions associated with applicable capital buffers, in the same manner and to the same extent as a BHC in accordance with any capital adequacy standards established by the Board for BHCs. In addition, a Foreign NFC would be required to certify to the Board that it meets capital adequacy standards at the consolidated level that are consistent with the Basel Capital Framework in accordance with any capital adequacy standards established by the Foreign NFC's home country supervisor or to demonstrate to the satisfaction of the Board that it meets capital adequacy standards at the consolidated level that are consistent with the Basel Capital Framework.

These requirements are wholly inappropriate for a Foreign NFC. The Basel Capital Framework is not intended to apply to insurance activities or insurance entities.[12] Moreover, as noted above, the IAIS is in the process of developing additional supervisory approaches, including higher loss absorption capacity, for G-SIIs that reflect the nature of insurance businesses. The application of bank-centric capital rules to a Foreign NFC that is predominantly an insurance enterprise would conflict with the authority of the home country insurance regulator and ultimately with the international approach being developed by the IAIS. The approach taken in the Proposed Rule toward capital and loss absorption capacity would be a prescription not for international harmonization, but for regulatory autarky.

A Foreign NFC will not be able to provide the certification or demonstration under the Proposed Rule that it meets the capital adequacy standards established by the Basel Capital Framework. Nor should any U.S. life insurance company subsidiary of a Foreign NFC be required to comply with the capital adequacy standards "in the same manner and to the same extent as a bank holding company." Any proposed capital framework for a U.S. insurance company subsidiary of a Foreign NFC must recognize the fundamental differences between life insurance companies and banking organizations to avoid the significant conceptual and practical problems that would arise from the imposition of a capital framework specifically designed for banking entities on insurance entities. The fundamental differences between the insurance industry and the banking industry must be taken into account by the Board as it designs risk-based capital and leverage requirements for any insurance company whether it is a subsidiary of a Domestic NFC or a subsidiary of a Foreign NFC. We direct the Board to our comment letter of April 25, 2012 for more detail on why bank-centric risk-based capital and leverage requirements are inappropriate for the insurance business.

C. <u>Liquidity</u>

As drafted, the Proposed Rule would require an FBO or a Foreign NFC to implement policies and procedures relating to liquidity risk management, including liquidity stress testing, the creation and maintenance of cash flow projections, and the establishment and maintenance of a contingency funding plan. A Foreign NFC would be required to establish a liquidity risk management framework within its U.S. operations, and would be required to establish and maintain policies and procedures that outline its liquidity stress testing practices, methodologies and assumptions, all based on a bank-centric approach. The Proposed Rule is even more prescriptive than the Domestic Proposal in requiring 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.

We again emphasize that any enhanced liquidity or liquidity risk management requirements for the U.S. life insurance company subsidiaries of a Foreign NFC must take into account the fundamental differences between insurance companies and banking organizations. Life insurers have a much different mix of liabilities on their balance sheets than traditional banking organizations, in that life insurer liabilities are predominantly long-dated (as in the case of a life insurance policy), rather than short-dated (as in the case of a bank deposit). It is unlikely that a life insurer will be subject to a "liquidity" problem arising from a lack of short-term funding. Liquidity risk management by life insurers is therefore appropriately informed by the fact that the risk of a short-term liquidity squeeze is low, and any enhanced liquidity requirements for a Foreign NFC that is a life insurer should take this into account. We have explained in our comment letter of April 25, 2012 in more detail the reasons why the liquidity

[12] *See* Basel Committee on Banking Supervision, *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Comprehensive Version) (June 2006) at 7, n. 6, *available at* http://www.bis.org/publ/bcbs128.pdf.

risk management requirements for a U.S. life insurance company must be tailored to its operations rather than to the typical banking operations. We direct the Board to that letter for more detail on why liquidity risk management for a U.S. life insurance company must be appropriately tailored to its operations. In addition, we urge the Board to take into account the need for coordination with the home country regulator in developing any liquidity requirements with respect to the U.S. life insurance operations of a Foreign NFC.

D. Single-Counterparty Credit Limits

The Proposed Rule would impose single-counterparty credit limits ("SCCL") on transactions between an FBO or a Foreign NFC and its counterparties. Credit transactions between an FBO's IHC or the FBO's combined U.S. operations and a single counterparty would be subject to a baseline limit of 25 percent of the capital stock and surplus of the Foreign NFC's IHC (in the case of the limit for the Foreign NFC's IHC) or the FBO's consolidated capital and surplus (in the case of the limit for the FBO's combined U.S. operations). "Major" entities, including Foreign NFCs, would be subject to a more stringent SCCL, the amount of which is still under consideration by the Board.

As is the case with much of the Proposed Rule, the proposed SCCL requirement is specifically premised on the structure and model of an FBO's operations, including with respect to the calculation of consolidated capital and surplus of the FBO. The FBO structure and model are unlikely to be relevant to the operations of life insurance enterprises. As the Board tailors the SCCL for Foreign NFCs, we also urge careful consideration of the differing levels of interconnectedness as between insurance companies and banking organizations. The SCCL is designed specifically to limit the risks that the failure of any individual firm could pose to a covered company, and thus any analysis by the Board of an appropriately tailored SCCL requires an analysis of the risks that the failure of individual counterparties could pose for a Foreign NFC that is a life insurer. We submit that the actual risks posed by counterparty failure are more limited in scope for an insurance group than for a banking organization, both because of the fact that insurers have longer-term liability structures than banking organizations, and therefore as an intertemporal matter are less vulnerable to the failure of a single counterparty, and because of the lower levels of interconnectedness between insurance groups and the financial system in general. We therefore strongly believe that any SCCL for a Foreign NFC that is a life insurer should be tailored to the actual level of the institution's interconnectedness with counterparties and the financial system as whole.

In tailoring any application of the SCCL to a Foreign NFC that is a life insurer, we believe that any SCCL for a Foreign NFC that is a life insurer must account for the fact that insurers hold significant amounts of long-dated assets, such as corporate and sovereign obligations, on their balance sheets, and that there are a limited number of issuers of such high-quality long-term assets. Corporate and sovereign obligations would generally be considered "credit exposures" for purposes of the SCCL requirement, and therefore the U.S. activities and subsidiaries of a Foreign NFC that is a life insurer could be subject to an SCCL requirement that failed to account for the fact that holding significant amounts of long-dated assets decreases, rather than increases its overall risk.

To the extent any SCCL requirement is applied to a Foreign NFC that is a life insurer, we urge the Board to exempt (i) direct exposures to the United States and its agencies, regardless of whether they are guaranteed as to principal and interest; (ii) direct exposures to U.S. States and their political subdivisions; and (iii) direct exposures to foreign governments that are members of the Organization for Economic Cooperation and Development from the SCCL.

E. Risk Management

The Proposed Rule would generally impose similar risk management requirements on FBOs and Foreign NFCs as the Domestic Proposal, "with certain adaptations to account for the unique characteristics of foreign banking organizations." In particular, the Proposed Rule provides that a Foreign NFC would be required to certify to the Board on an annual basis that it maintains a committee that (1) oversees the U.S. risk management practices of the company and (2) has at least one member with risk management expertise.

The Proposed Rule is based explicitly on an FBO's organizational structure – for example, the Proposed Rule provides that an FBO could choose between maintaining its U.S. risk committee (1) as a committee of its head office board of directors or (2) as a committee of the board of directors of its U.S. IHC. A Foreign NFC that has both U.S. life insurance operations and U.S. property and casualty insurance operations may have designed its risk management structure along robust parallel lines, rather than on a consolidated basis. Any risk management requirements for Foreign NFCs must provide the necessary flexibility to reflect the differences between the U.S. business lines in which the NFC may be engaged.

F. Stress Testing

The Proposed Rule contemplates that an FBO or a Foreign NFC would be subject to the annual supervisory and semi-annual company-run stress testing requirements of the recently adopted Regulation YY. In addition, an FBO or a Foreign NFC would be required to be subject to a consolidated capital stress testing regime that includes either an annual supervisory capital stress test conducted by the company's home country supervisor or an annual evaluation and review by the company's home country supervisor of an internal capital adequacy stress test conducted by the home country. The Board recently issued final rules establishing stress testing requirements under Section 165 of the Dodd-Frank Act for Large BHCs and Domestic NFCs.[13] In those final rules, the Board noted its ability to tailor the application of enhanced standards to nonbank financial companies, and stated that it expected to "take into account differences among [BHCs] and nonbank covered companies supervised by the Board when applying enhanced supervisory standards, including stress testing requirements."[14]

We agree with this statement, and urge the Board to take into account the significant differences between Foreign NFCs and banking organizations when developing stress testing requirements for Foreign NFCs. In particular, the Board should tailor any stress testing requirements for the U.S. insurance subsidiaries of Foreign NFCs to take into account the differing risks that life insurers face as compared to banking organizations. Insurance companies face risks that are often unique to their business model, and any stress testing regime for insurers should be tailored to take these risks into account, such as mortality risks or risks arising from a natural disaster. Any stress testing regime for the U.S. insurance subsidiaries of a Foreign NFC should similarly de-emphasize risks arising from banking and trading activities, as these activities are likely to have comparatively less impact on a life insurer's capital position and overall risk profile.

In addition, any stress testing regime for the U.S. insurance subsidiaries of a Foreign NFC should ensure that the NFC is not required to provide bank-centric data that would be of little use when stress testing an insurance enterprise. For example, the stress testing requirements of the Proposed Rule would appear to require a Foreign NFC to provide estimates to the Board of pre-provision net revenues and total loan loss provisions, metrics that are of little relevance to the activities of an insurance enterprise. We urge the Board to tailor any stress testing-related information requirements to ensure that data can be gathered and collected by the insurer and is relevant to the risks facing an insurance enterprise.

Finally, the Board in tailoring the stress testing requirements should make appropriate recognition for the differing stress testing requirements that home country jurisdictions apply to life insurers.

G. Debt-to-Equity Limit

---

[13] Supervisory and Company-Run Stress Test Requirements for Covered Companies, 77 Fed. Reg. 62,378 (Oct. 12, 2012).
[14] 77 Fed. Reg. 62,380.

The Proposed Rule provides that an IHC and any subsidiary of an IHC would be required to maintain a debt-to-equity ratio of no more than 15-to-1 upon a determination by the FSOC that the FBO posed a grave threat to the financial stability of the United States and that the imposition of such a requirement was necessary to mitigate the risk that the FBO poses to the financial stability of the United States. The Proposed Rule further provides that the U.S. branch and agency networks of an FBO must maintain on a daily basis eligible assets in an amount no less than 108 percent of the preceding quarter's average value of the network's liabilities. As with many of the other provisions in the Proposed Rule, it is not clear how this provision would be applied to a Foreign NFC that is a life insurer. Assuming that the provision is only intended to be applied to U.S. subsidiaries of a Foreign NFC, it nonetheless presents unique issues.

Like the Domestic Proposal, the Proposed Rule defines the term "debt" to mean "total liabilities." As we discussed in our April 25, 2012 letter, the substitution of the term "total liabilities" for the term "debt" is in conflict with the language of Section 165(j). It also results in inequitable consequences when applied to life insurance operations. Insurers have significantly different liability structures than banking organizations, and account for these liabilities in a significantly different manner than banking organizations. Under statutory accounting principles, insurers account for future liabilities arising from underwritten insurance policies and hold reserves in anticipation of those future liabilities. These reserves for future policy liabilities represent a significant portion of an insurer's total liabilities, and are not comparable in kind or in relative size to the reserves held by banking organizations. Similarly, life insurers maintain separate accounts, which are reflected as assets and offsetting liabilities on their balance sheets. Separate accounts are unique to insurers and are not comparable to any type of asset or liability for banking organizations. Regardless of whether an argument can be made in support of using total liabilities as a proxy for debt in the case of a banking organization, substituting the phrase "total liabilities" for "debt" in the case of an insurance company fails to take account of the fundamental differences between life insurers and banking organizations. We specifically submit that the substitution of "total liabilities" for the statutory term "debt" is inappropriate and unauthorized as applied to any insurance company.

V. Early Remediation Framework

The Proposed Rule would establish an early remediation framework for FBOs and Foreign NFCs that, like the Domestic Proposal, would be based on the prompt corrective action ("PCA") rules currently applicable to insured depository institutions under the Federal Deposit Insurance Act. The early remediation framework would be applied in general to the U.S. operations of an FBO or a Foreign NFC in the event of various triggering events. Because the early remediation triggers are principally based on the PCA framework, the early remediation triggers are by and large bank-centric in focus and hence suffer from the same kinds of defects that affect the other proposed standards.

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

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

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

Although the proposed early remediation framework is clearly bank-centric in design, its major flaw would negatively impact both Foreign NFCs and the larger international financial system. Specifically, there is a danger that the early remediation requirements will inappropriately restrict a company's ability to take actions necessary to mitigate its financial distress. For example, a company subject to Level 2 remediation could be prohibited from acquiring assets to hedge outstanding risks or engaging in certain asset/liability management activities that could enhance its overall liquidity position. If a covered company were prevented from taking such actions, the odd result would arise that the early remediation framework would be exacerbating exactly the types of problems that it was intended to mitigate.

Finally, we submit that any approach to an early remediation framework for Foreign NFCs must take appropriate recognition of and be coordinated with international efforts to develop effective recovery and resolution regimes for insurance groups. For example, the IAIS framework specifically envisions that G-SIIs will prepare recovery and resolution plans. Any early remediation regime applicable to the U.S. subsidiaries of a Foreign NFC must not be in conflict with these international frameworks.

VI. Conclusion

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

Respectfully submitted,

Julie A. Spiezio

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