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July 21, 2016

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

Re: Department of the Treasury, Office of the Comptroller of the Currency, 12 CFR Part 42 [Docket No. OCC–2011–0001] RIN 1557–AD39, Federal Reserve System 12 CFR Part 236 [Docket No. R–1536] RIN 7100 AE–50, Federal Deposit Insurance Corporation, 12 CFR Part 372 RIN 3064–AD86, National Credit Union Administration, 12 CFR Parts 741 and 751, RIN 3133–AE48, Federal Housing Finance Agency, 12 CFR Part 1232, RIN 2590–AA42, Securities and Exchange Commission, 17 CFR Parts 240, 275, and 303 [Release No. 34–77776; IA–4383; File No.S7–07–16] RIN 3235–AL06 Incentive-Based Compensation Arrangements

Dear Secretary deV. Frierson:

The National Association of Mutual Insurance Companies ("NAMIC") appreciates the opportunity to provide comments regarding the proposed rules and request for comment set forth above (the "Notice").

NAMIC is the largest property/casualty insurance trade association in the country, serving regional and local mutual insurance companies on main streets across America as well as many of the country's largest national insurers. The 1,400 NAMIC member companies serve more than 135 million auto, home and business policyholders and write more than $196 billion in annual premiums, accounting for 50 percent of the automobile/homeowners market and 31 percent of the business insurance market. Through our advocacy programs, we promote public policy solutions that benefit NAMIC companies and the consumers we serve.

Background

The OCC, Board, FDIC, FHFA, NCUA, and SEC (the Agencies) are seeking comment on a joint proposed rule (the proposed rule) to revise the proposed rule the Agencies published in the Federal Register on April 14, 2011, and to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Specifically, section 956 of the Dodd-Frank Act (''section 956'') requires that the Agencies prohibit any types of incentive-based compensation arrangements, or any feature of any such arrangements, that the Agencies determine encourage inappropriate risk-taking by a covered financial institution:

> (1) By providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or
>
> (2) that could lead to material financial loss to the covered financial institution.

Section 956(c) further provides that the appropriate Federal regulators shall—

> (1) ensure that any standards for compensation established under subsections (a) or (b) are comparable to the standards established under section 1831p–1 [1] of this title for insured depository institutions; and
>
> (2) in establishing such standards under such subsections, take into consideration the compensation standards described in section 1831p–1(c) of this title.

Under the Act, a covered financial institution also must disclose to its appropriate Federal regulator the structure of its incentive-based compensation arrangements sufficient to determine whether the structure provides excessive compensation, fees, or benefits or could lead to material financial loss to the institution.

The Notice Warrants More Time for Analysis and Comment

The Notice is extensive. It covers 170 pages in the Federal Register and includes hundreds of specific and general multi-part questions, most of which are attached hereto. An original version of the Notice was proposed five years ago and in the recent past various agencies have published varying versions of proposed rule, which have both adopted and revised prior sections. This Notice, which would be applied by six federal agencies to literally thousands of different financial services companies, was issued with a request for comments in less than 30 business days which included a holiday weekend.

As noted below, the Notice attempts to provide broad standards to define broad concepts for banks, brokers, investment advisors and myriad other financial services companies. The Notice attempts to provide clear standards to different types of companies for nebulous concepts such as inappropriate and appropriate risks, excessive and reasonable compensation, and material and immaterial financial loss to the covered financial institution.
In June 2016, NAMIC requested an extension of time to allow for a full evaluation of the wide range of proposed changes that would significantly impact the varied operations of affected members. We have received no reply, nor have there been any indications that an extension would be provided. We reiterate our request for additional time to comment on the Notice, but provide the following general comments in the interest of complying with the proposed comment period.

Statutory Authority

The Agencies are directed to jointly prohibit certain incentive-based payment arrangements; however, the proposed Notice goes far beyond the statutory authorization. The statute explicitly directs the Agencies to ensure that limitations are consistent with standards for insured depository institutions taking into account described compensation standards. The statute does not provide for mandatory deferral, forfeiture or clawback; however, the Agencies have included such provisions. Under the proposed rule, Level 1 and Level 2 covered institutions would be required to impose mandatory deferral of certain amounts of incentive-based compensation. In addition, the Notice proposes to require Level 1 and Level 2 covered institutions to make subject to forfeiture all unvested deferred incentive-based compensation of any senior executive officer or significant risk-taker, including unvested deferred amounts awarded under long-term incentive plans.

Similarly, a Level 1 or Level 2 covered institution would also be required to make subject to downward adjustment all incentive-based compensation amounts not yet awarded to any senior executive officer or significant risk-taker for the current performance period, including amounts payable under long-term incentive plans.

The proposed rule also includes a new provision not included in the 2011 proposal, to require clawback provisions that, at a minimum, allow the covered institution to recover incentive-based compensation from a current or former senior executive officer or significant risk-taker for seven years following the date on which such compensation vests, if the covered institution determines that the senior executive officer or significant risk-taker engaged The Agencies note that foreign jurisdictions have introduced new compensation regulations for certain financial institutions including deferral, forfeiture and clawback. Despite, the Agencies' assertion that the practice is increasingly common with foreign jurisdiction, the practice of foreign jurisdictions does not provide statutory or other legal authority for the federal Agencies to mimic such standards or practices. The authority of the Agencies to promulgate regulations is derived from Section 956, which does not include authority for deferral, forfeiture or clawback.

The Notice Should Be Explicit that Insurance Companies and Subsidiaries are Exempt from the Provisions of the Notice

Under the proposed rule, a ''covered institution'' would include:

- A subsidiary of a national bank, Federal savings association, or Federal branch or agency of a foreign bank, if the subsidiary is not a person providing insurance.

- A subsidiary of a state nonmember bank, state savings association, or a state insured branch of a foreign bank that is not a person providing insurance.

The proposed rule is predicated on analysis of banking institutions. The Notice references a study that finds evidence that insurance companies have become highly interrelated during the last decade, thus increasing the level of systemic risk in the financial sector, and that some insurance activities have potential implications for systemic risk when conducted on a large

scale. However, more study and analysis should be undertaken focused specifically on various types of businesses – including insurance – that could be subject to the requirements. Insurers and other institutions should not be assumed to mirror banking operations.

The Agencies should carefully examine these businesses to determine whether if it appropriate to include them in the compensation limits and if appropriate determine appropriate threshold levels and degrees of regulatory oversight. As example, Question 2.12 in the Notice specifically asks if the determination of average total consolidated assets be further tailored for insurance companies and, if so, why and in what manner. Such questions go to the heart of the proposed rule and are more appropriate for a request for comment or advance notice of proposed rulemaking, not a notice of proposed rulemaking.

The proposed rule fails to recognize and address the fundamental differences between insurance and other financial services industries. There are significant differences in the assets held by insurers than those held by banks or asset managers. Assets held by insurers are highly regulated by functional regulators at the state level. The Agencies argument that large depository institution holding companies increasingly operate and manage their businesses in such a way that risks affect different subsidiaries within the consolidated organization and are managed on a consolidated basis represents a fundamental misunderstanding of the regulation of insurance assets and operations. As the financial crisis of 2008 proved, the process by which insurance company assets are ring-fenced and segregated from the assets of non-insurance operations, provided stability to the insurance industry.

The Agencies also mistakenly argue that decisions about business lines including management and resource allocation may be made by executives and employees in different subsidiaries. In the case of insurance subsidiaries, we argue that this is not the case. Virtually every aspect of insurance operations is highly regulated and closely supervised. Decisions regarding the operations of insurance units are made by professionals within those units to ensure compliance and the exercise appropriate risk management and corporate governance. The Agencies further argue that incentive-based compensation programs are designed at the holding company level and applied uniformly throughout the consolidated organization. In the case of most SLHC's that are primarily insurance focused, the size of the depository institution relative to size of the consolidated group is relatively small. Compensation systems for these smaller components are highly unlikely to drive compensation structures group wide.

The Agencies also argue that the proposed rule would be consistent with the requirements of overseas regulators requiring that the rules governing incentive-based compensation be applied at the group, parent, and subsidiary operating levels. We reiterate that the Agencies have not been delegated statutory authority by Congress to conform U.S. standards with international standards. Consistency with international standards for the sake of consistency is – and should not be – a policy goal of the Agencies. The Agencies should take their direction from the statute and legislative history.

The Agencies argue that rule is tailored to reflect the size and complexity of each of the three levels of covered institutions identified. While the proposed rule recognizes differences in size of institutions, it fails to recognize that in the case of insurance-centric SLHCs the size of the

non-insurance units is often small. The clear legislative intent of Section 956 was to limit the potential for systemic risk to threaten the financial stability of the overall financial system. None of the depository institutions controlled by insurance-centric SLHC's pose a systemic risk. Imposing stringent and arbitrary limits on incentive based compensation across the entire consolidated group as a result of the presence of relatively small depository institution in terms of the SLCH that poses no systemic risk is arbitrary and capricious.

The proposed rule also flies in the face of recent actions taken by the Federal Reserve with respect to capital standards for savings and loan holding companies with insurance components. The Federal Reserve recognized that bank-centric capital standards are not appropriate in the insurance context. Just as a single approach is not appropriate for capital, it is not appropriate for compensation practices. We urge the Agencies to recognize these fundamental differences.

Finally, we note the inherent conflict between the approach in the proposed rule and the in the efforts of the Agencies to establish more stringent standards for institutions designated as systemically important financial institutions (SIFIs). Section 165 of the Dodd-Frank Act requires the the Federal Reserve to adopt standards that are more stringent than those applicable to non SIFIs. We note that the Federal Reserve carefully and thoroughly deliberated the rules for compensation for designated SIFIs. It appears that a similar analysis was not considered in the case of insurance-centric SLHCs under the proposed rule. Adoption of a one-size-fits-all incentive-based compensation standard applicable to SIFIs and non-SIFIs would appear to create an inherent incongruity between standards adopted under Sections 956 and 165.

Systemic Risk

NAMIC strongly disagrees that insurance companies entail systemic risk and requests that the Notice make clear that insurance companies are not covered under this rule. State regulations limit risk taking by specifying quality and type of investment. Most insurer investments are low risk instruments, such as treasury bills, municipal bonds and high grade corporate bonds. These instruments do not contribute to systemic risk, nor are they likely to lead to material financial loss to the institution. Failure of the Agencies to differentiate between these assets inappropriately attempts to impose a one-size-fits-all compensation system on a varied, dynamic financial services industry.

The regulations on executive compensation in the Notice are focused on systemic risk and are not applicable to property/casualty insurance. The Notice should be explicit that traditional property/casualty insurers are exempt from the proposed provisions, as traditional property/casualty insurers should not be subject to systemic risk regulation. The very nature of the industry's activities – and mutual companies in particular, specifically relating to conservative business strategies, incentives, and risk-taking – are not reflective of systemic risk, and the executive compensation requirements to reduce system risk are not applicable.
The six primary factors that affect the probability that a financial institution will create or facilitate systemic risk are leverage, liquidity, correlation, concentration, sensitivities, and connectedness. An examination of these factors demonstrates that there is no basis for regulating property/casualty insurance companies for systemic risk because, simply, they don't present such a risk.

Leverage

Very few property/casualty insurers use commercial paper, short-term debt, or other instruments that may be used to leverage their capital structures, a fact that makes them less vulnerable than highly leveraged institutions when financial markets collapse. Because of their basic business model and strict capital requirements imposed by state regulators, property/casualty insurers are much more heavily capitalized in terms of their asset-to-liabilities ratios than banks and hedge funds. For these reasons alone, the banking system's perennial moral hazard of being "too big to fail" has no equivalent in the insurance industry. This, of course, is a completely different model than the banking world where leverage is a central component of the enterprise.

Liquidity

Unlike most other types of financial institutions, the nature of the products that property/casualty insurers provide makes them inherently less vulnerable to disintermediation risk. While banks are exposed to the risk that customer withdrawals can exceed available liquidity, the risk of a liquidity shortfall is minimal for insurance companies. Insurance companies are financed by premiums paid in advance, and payments are subject to the occurrence of insured events. Insurance policies are also in force for a contracted period of time, the terms of which are agreed to by both parties.

If an insurance customer cancels a policy before the end of the contract, the premium is refunded on a pro rata basis and coverage is canceled. Whereas bank liabilities are short-term and assets are long-term, insurance has liquid assets, but longer-term liabilities. Thus, for both business and regulatory reasons, property/casualty insurers carry a liquid investment portfolio. As long as the insurance company has built up reserves and its investments are calibrated to match the statistically anticipated claims payments, there is limited liquidity risk and no possibility of a "run-on-the-bank" scenario.

Correlation

Property/casualty insurers use underwriting tools specifically designed to identify and control certain types of correlation, including market concentration, in order to control catastrophe and underwriting exposures. Identifying and managing risks are at the core of insurance and these tools allow insurers to accurately price and underwrite risk. The side benefit of rigorous underwriting is a reduction in systemic risk exposure. It is also important to note the difference between asset-backed securities and other derivative products, where the underlying risk is financial or market (such as credit, price, interest rate, or exchange rate), and property/casualty insurance, where the underlying risk is a more tangible event, such as an automobile accident, fire, or theft. While the former risks are likely to be correlated in that they will be affected by similar cyclical economic or financial factors, the latter are largely individual, non-cyclical idiosyncratic risks. Banking risks are often highly correlated, particularly in economic downturns. Traditional insurance, in contrast, pools uncorrelated idiosyncratic risks, and is not subject to systemic crises in the same way as banks.

Connectedness/Sensitivities/Concentration

Property/casualty insurers manage concentrations of investments and have regulatory limitations on both the type and concentrations of the assets in which they invest. These realities have the effect of reducing the property/casualty insurance industry's connectedness and sensitivity to the

actions and conditions of other sectors of the financial services industry. Property/casualty insurers, like virtually all investors, suffered investment losses during the financial crisis. But, no contagion of losses was spread throughout the industry or from the industry to other financial markets.

Even when a property/casualty insurer is part of a holding company that also holds other types of financial services companies, regulatory restrictions designed to protect policyholders operate to isolate the property/casualty insurer's capital and protect it from incursions caused by any problems of the other subsidiaries. Unlike the obligations of financial institutions such as investment banks and hedge funds, most of the obligations of property/casualty insurers are protected by the insurance guaranty fund system. This nationwide system, financed by the property/casualty insurers of each state, reduces the systemic impact of any failing property/casualty insurer by providing customers or claimants with assurance that most of the insurer's obligations will be satisfied on a timely basis.

In the aftermath of AIG's 2008 collapse and bailout, and the concurrent world financial crisis, tremendous attention has been paid to systemic risk regulation with respect to insurance. Almost universally, those studying the issue have concluded that insurers engaged in traditional or "core" insurance activities, pose little if any systemic risk. In November 2011, the International Association of Insurance Supervisors ("IAIS"), which represents insurance regulators and supervisors from approximately 190 jurisdictions, issued a comprehensive report on financial stability and insurance which concluded, among other things, that:

- The business model of insurers generally enabled them to withstand the financial crisis of 2008-2009 better than other financial institutions;
- The characteristics of the insurance business model including insurance techniques make it very unlikely for traditional insurance to be systemically relevant;
- The historical evidence of insurance runs is limited;
- In traditional insurance the risk of a liquidity shortage is small;
- Insurance markets tend to be competitive;
- For most lines of business there is little evidence of traditional insurance either generating or amplifying systemic risk within the financial system or in the real economy; and
- Insurers engaged in traditional insurance activities were largely not a concern from a systemic risk perspective.

These conclusions fully support the idea that the truest markers of systemic risk are unregulated interconnected activities that are highly leveraged, and subject to runs on the bank—and that none of these markers are present in connection with core/traditional insurance businesses. The legislative history of the Dodd-Frank Act further suggests that lawmakers did not believe that the traditional business of insurance generally poses a systemic risk and there is currently no evidence that the property/casualty insurance industry contributes any substantial amount of systemic risk to the global financial system. In addition, in its latest proposed rulemaking on systemic risk, the Financial Stability Oversight Council also appears to have acknowledged the risk factors in screening nonbank financial companies for systemic risk by focusing on metrics

indicative of heavy debt, high leverage, illiquidity, and interconnectedness (e.g., short-term debt and leverage ratios, loans and bonds outstanding, derivatives liabilities, and credit default swaps outstanding). Lawmakers and regulators agree that the best way to protect against a systemic risk to the economy is to protect the solvency of companies, which we believe the state system does well.

The Notice should be explicit that insurance companies and subsidiaries are exempt from the provisions of the Notice as Section 165 of Dodd Frank already addresses "Enhanced Supervision and Prudential Standards for Nonbank Financial Companies Supervised by the Board of Governors and Certain Bank Holding Companies". Section 956 addresses "Enhanced Compensation Structure Reporting" of covered financial institutions. The Agencies have already addressed the compensation of certain nonbank financial companies in a separate rulemaking, and the present rule should make explicit that the provisions of Section 956 that deal with covered companies should not be interpreted to inappropriately be expanded to nonbank financial companies.

It is important to note that this Notice is promulgated under Section 956, which is part of Title IX of Dodd Frank "Investor Protections and Improvements to the Regulation of Securities", with a short title of the ''Investor Protection and Securities Reform Act of 2010''. The investor protection provisions of Title IX apply specifically to the public securities markets and the protection of investors in securities in those markets. There is nothing in Title IX that indicates that any section of Title IX applies to anything but the public securities markets and the protection of investors in securities in those markets. Mutual insurance companies do not have publicly traded securities or investors. Accordingly, the Notice should make clear that the provisions of Section 956 and other provisions of Title IX are not applicable to mutual insurance companies and other legal entities that are not publicly traded securities or have investors.

Measures of Risk and Risk Outcomes May be Better Left to Senior Management at Covered Institutions than Defined in Prescriptive Rules

NAMIC appreciates that section 956 of the Dodd-Frank Act requires the Agencies to prohibit incentive-based compensation arrangements that encourage inappropriate risks through excessive compensation, fees, or benefits that could lead to material financial loss. The proposed rule defines incentive base compensation as "any variable compensation, fees, or benefits that serve as an incentive or reward for performance." The definition of incentive compensation is vague and so broadly drawn that it could ensnare virtually any variable compensation. The proposed rule also fails to distinguish between compensation systems that reward specific individuals and those that compensate broad classes of employees based on enterprise or company-wide performance metrics that a single individual within the organization would have no meaningful way to impact.

The proposed rule is predicated on an article of faith that any form of variable compensation increases risk. This assumption, particularly in the context of insurance operations, is unsupported by empirical evidence or experience. The Agencies are directed to prohibit compensation arrangements that encourage inappropriate risk taking. The statute does not direct the Agencies to bar all incentive base compensation and the mere fact that compensation can

vary, without further analysis confirming inappropriate risk taking, is insufficient under Section 956 to warrant restriction in an effort to limit unnecessary risk. To meet the letter and spirit of the law, it is necessary to identify compensation factors that are directly related to increased risk. The vague and overly broad definition of incentive compensation fails to establish a the link between the compensation system and increased risk and renders the rule arbitrary and capricious.

The overly broad definitions and lack of specificity spotlight the lack of analysis conducted by the Agencies into compensation systems prevalent in types of businesses other than depository institutions covered by the proposal. Statutory requirements mandate that the Agencies look to comparable compensation practices at comparable institutions; however, it is clear from the proposed rule that little analysis was completed of the practices at comparable insurance operations.

The Notice provides that "reliable quantitative measures of risk and risk outcomes, where available, may be particularly useful in both developing incentive-based compensation arrangements that appropriately balance risk and reward and assessing the extent to which incentive-based compensation arrangements properly balance risk and reward", but go on to acknowledge that "reliable **quantitative** measures may not be available." The Notice also acknowledges that "risks associated with some business lines may require many years before they materialize" and that "some evidence of inappropriate risk taking, risk management failures and misconduct may not be immediately apparent to the covered institution." We believe this lack of analysis, coupled with the vagueness of the definition, call for nothing less than additional study and reproposal.

At a minimum, any final rule should include adequate safe harbor protections. NAMIC urges that Agencies to provide a safe harbor rule for broadly applied incentive compensation programs that are based on company or enterprise-wide performance results that are not capable of being manipulated by any single individual, provided such programs are subject to the type of recordkeeping, oversight and governance contemplated for Level 3 institutions. The safe harbor should exempt such programs from deferral, forfeiture or clawback requirements. NAMIC would also urge a safe harbor to establish a minimum threshold, such as $1 million annually, to limited unwarranted impact of the proposal.

Section __.7(b) of the proposed rule would require a Level 1 or Level 2 covered institution to conduct a forfeiture and downward adjustment review based on certain identified adverse outcomes. Under section __.7(b), events that would be required to trigger a forfeiture and downward adjustment review include: (1) Poor financial performance attributable to a significant deviation from the risk parameters set forth in the covered institution's policies and procedures; (2) inappropriate risk-taking, regardless of the impact on financial performance; (3) material risk management or control failures; and (4) non-compliance with statutory, regulatory, or supervisory standards.

The Agencies recognize that not all inappropriate risk-taking does, in fact, lead to poor financial performance, but the Notice specifically provides that poor financial performance can indicate that inappropriate risk-taking has occurred at a covered institution.

The Notice includes retroactive determinations when "evidence of past material risk management or control failures becomes known." The Notice provides trigger examples of "failing to properly document or report a transaction or failing to properly identify and control the risks that are associated with a transaction." After the fact determinations would incriminate other people in the Notice as well, where "peers that were aware of the misconduct, managers supervising the covered person directly involved in the misconduct, and control staff who should have detected but failed to detect the behavior would be considered for a reduction."

We are confident that the Agencies would agree that the majority of the incentive-based compensation arrangements at covered institution do not encourage inappropriate risks through excessive compensation, fees, or benefits that could lead to material financial loss. The Notice would now require institutions to review and monitor these arrangements with respect to poor financial conditions, retroactive conditions and peers.

The Notice provides that covered institutions would be permitted to define additional triggers based on conduct or poor performance, acknowledging that the determination of "inappropriate", "excessive" or "material" may be highly dependent on the institution, its business, the existing market conditions, management and myriad other factors. NAMIC suggests that the wide breadth and depth of these companies and factors indicates that the determination of "inappropriate", "excessive" or "material" is perhaps better addressed under the fiduciary duties of the senior management of the covered institution than by a one-size-fits-all regulation.

To reasonably and adequately address the issue, the Agencies could instead provide that senior management of covered institutions be required to exercise their business judgement and to review and verify that the incentive-based compensation arrangements at that institution do not encourage inappropriate risks through excessive compensation, fees, or benefits that could lead to material financial loss. False or reckless filings with the Agencies would be subject to the existing, relevant Agency penalties for false or reckless statements.

Conclusion

Accordingly, NAMIC believes that the Agencies should extend the period for comment on the Notice, make explicit that property casualty insurance companies are not subject to the Notice, and that determinations of incentive-based compensation arrangements be best left to the business judgement of the senior management at the covered institutions.

If you have questions or comments, please feel free to contact me at 202-628-1558, tkarol@namic.org.

Respectfully submitted,

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