80 Pine Street, 13th Fl
New York, NY 10005
www.aig.com

Daniel L. Rabinowitz
T 212 770 3068
F 855 665 8281
Daniel.Rabinowitz@aig.com

August 18, 2016

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Advance Notice of Proposed Rulemaking (Docket No. R–1539; RIN 7100 AE 53) on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities

Dear Mr. Frierson:

American International Group, Inc. (AIG) appreciates the opportunity to offer comments on the Federal Reserve Board's ("Board") advance notice of proposed rulemaking ("ANPR") on capital requirements for supervised institutions significantly engaged in insurance activities. We welcome the Board's commitment to developing a framework that is tailored to the stable funding structure, risk management practices, and diversified risk profile of insurance groups.

Our comments in this letter are based on the principles of stewardship and policyholder protection that AIG believes are fundamental to a group capital framework:

- **Customer protection** and maintaining the financial strength to meet our obligations to policyholders;

- A prudent and risk-based assessment of **capital** that promotes and enhances confidence within the insurance sector and across the broader financial system;

- Enough **comparability** in requirements across markets and products offered by a wide range of industry participants to mitigate distortive regulatory arbitrage incentives and allow for the role that global market participants must play in promoting market integrity and stability; and

- Protection of market-based **competition** in service of a level playing field and the continued provision of socially-useful products to customers.

AIG views the following policy considerations as critical to the development of a tailored group capital framework that is anchored in these fundamental principles:

- **Asset and insurance product capital charges that are appropriately sensitive to underlying risks and tailored to insurance industry modalities,** notably:

  - ***Asset-risk charges*** should be designed and calibrated to reflect the general stability of insurer funding models and the insulation from run risk of most insurance products. Insurance companies are less exposed than most other financial institutions to short-term funding liquidity pressures, which are the catalyst of illiquidity-driven asset "fire sales" that lie at the heart of regulatory concerns about systemic risk. Stability in insurer liquidity profiles is supported by limited use of short-term wholesale funding; matching of asset and liability maturity profiles, which reduces exposure to short-term asset market volatility; and an inverted liquidity profile, since premium payments are received in advance of liabilities incurred over the longer-term. To promote appropriate risk-sensitivity, the Board should design and calibrate its asset risk charges for insurance companies to reflect this minimal "fire sale" risk.

- Similarly, for ***insurance risk capital charges***, we believe that the Board's design and calibration efforts must recognize that core insurance activities typically do not have a high degree of correlation with financial market stress, and are therefore not as pertinent to the Board's systemic risk oversight and mitigation mandate. For insurance risks that are demonstrably non-systemic in nature, particularly non-financial insurance risks within life and property and casualty, we believe that the Board should apply risk-sensitive charges that align with empirical evidence, actuarial experience, and jurisdictional regimes of longstanding and successful vintage. Alignment in product-specific risk charges across the constructs proposed in the ANPR will be crucial to achieving a risk-based and appropriately tailored group capital framework.

- **Application of consistent capital requirements on the same or similar activities, irrespective of the entity that boards the risk.** It is essential, particularly in an insurance group regulatory regime with a differentiated capital construct for companies designated as systemically-important financial institutions (SIFIs), that the risk charges at a product-level are materially comparable across both SIFI and non-SIFI firms. Material differences in risk charges across firms for the same underlying risk exposure would likely create unwarranted and artificial competitive imbalances. We therefore urge the Board that, to meet its prudential objectives while not disrupting the integrity of a competitive insurance market, it develop the proposed capital constructs in a parallel and closely integrated manner. The implementation of capital requirements, for both SIFIs and non-SIFIs alike, must not impose unwarranted and asymmetric regulatory capital constraints, which would unnecessarily hamper competitive equity and the provision of socially-useful insurance products across a range of markets.

- **Enterprise-wide view of insurer risk exposure, with explicit recognition of group-wide diversification in incentivizing the mitigation of highly-correlated risks.** We believe the regulatory capital construct must be enterprise-wide in scope, capturing quantifiable insurance and financial risks across both regulated and unregulated entities within the group. In aggregating an insurer's enterprise risks, it is important to recognize that, while intra-financial risks are driven by similar risk factors and should be aggregated assuming higher correlations, the potential losses from financial shocks and insurance-related stresses (e.g., natural or man-made catastrophes; mortality) are much less likely to manifest simultaneously. Incorporating differentiated and explicit estimates of cross-risk correlation, based on empirical study, sound analysis, and documented experience, is instrumental to aggregating an insurer's required capital. Such an approach promotes both the credibility of the resulting standard through closer alignment with underlying economic risk as well as the prudential and economic incentives to mitigate risk concentrations, deter regulatory arbitrage, and provide socially-useful products with low correlations to the rest of portfolio. The explicit recognition of diversification is well-established within both regulatory and industry insurance risk capital methodologies, including US risk-based capital (RBC) requirements, Solvency II, and the Swiss Solvency Test.

- **A definition of available capital that is initially anchored in tractable and transparent modifications to GAAP.** AIG agrees with the Board that the definition of capital should initially be a modification of GAAP, which enables closer alignment with our published financials and transparency to external stakeholders in assessing AIG's group regulatory capital position. We believe that the Board should develop a pathway for the domestic capital construct to be based on a more economic basis of liability valuation, as conventions and practices evolve in this direction in the future. Modification of GAAP to achieve a more economically-driven view involves tailoring the definition of available capital through targeted adjustments to published GAAP financials to better align the sensitivity of assets and liabilities to movements in the market environment, particularly interest rates. Another important area for tailoring is to ensure that the definition of available capital reflects an appropriate, demonstrable degree of loss absorption for an insurer under stress. For example, the scope of recognition of deferred tax assets (DTA) should be grounded in an analysis of the asset recoverability and loss absorption of the DTA for insurance-related activities under stress.

- **A design and calibration that is proportional and complementary to existing insurance regulatory structures, both well-established jurisdictional requirements and evolving Federal Reserve group supervision and regulation.** It is vital that the Board design its group capital requirements in a way that respects and complements the well-established and time-tested jurisdictional capital requirements that apply to insurance operating entities. The Board must also consider the effective protections already provided by the broader framework of prudential supervision and regulation for insurance companies, including both at the jurisdictional level as well as by the emerging Board requirements for liquidity risk management, enterprise risk management and governance, recovery and resolution planning, and group supervision. It is also critical for the Board to acknowledge that, for certain enterprise risks, capital requirements are not necessarily the only nor optimal mechanism for risk assessment and mitigation.

AIG supports the consolidated, factor-based approach (CA) as the appropriate course for achieving these important policy objectives. AIG believes that a consolidated approach, designed according to these essential elements of a tailored framework, will confer valuable prudential benefits for the industry and supervisors alike, notably:

- **Consistent treatment of risk exposures across the enterprise**, which provides a more coherent assessment of group-wide risk exposure and capital adequacy that is agnostic to the location of the risk within the organization. A consistent enterprise-wide treatment of risk exposure mitigates potential incentives for regulatory arbitrage within the group regulatory regime. A consolidated approach also complements the well-established and successful jurisdictional insurance capital requirements in ways that add value to the capital regulation and supervision of operating legal entities.

- **A pathway for alignment with, and concomitant influence on, a globally-accepted standard** that does not require costly implementation of complex Solvency II-like models in subsidiaries. In particular, we note the beneficial comparability in architecture between the consolidated approach proposed in the ANPR with the international capital standard (ICS) that the International Association of Insurance Supervisors (IAIS) is in the process of developing. Future alignment of the Board's capital standard with a more evolved ICS would enable cross-jurisdictional comity and market access, which is of vital interest to the competitiveness of the US insurance industry in an increasingly globalized insurance market.

- **Integration with the Board's group-wide stress testing, regulatory reporting, and group supervision objectives**, which are principally anchored in a consolidated enterprise view. Additionally, the application of a factor-based approach to required capital would provide tractability, transparency, and reasonable risk differentiation, which can be integrated with the Board's consolidated stress testing program to deliver compensatory risk-sensitivity.

Development of the CA will require thoughtful deliberation, iterative public consultation, and rigorous quantitative analysis and testing, leveraging not only the ongoing and future field testing exercises being coordinated by the IAIS but also appropriately designed quantitative impact study (QIS) exercises, a process that was fundamental to the Board's development of banking capital standards.

To follow, we provide AIG's responses to specific questions which the Board poses in the ANPR. We look forward to continuing dialogue with the Board in the design and development of a group capital standard that is meaningful, sustainable, and valuable to the stakeholders engaged in this important process.

Respectfully Submitted,

Daniel L. Rabinowitz
Global Head of Regulatory Capital Policy

ANPR: AIG response to questions

Question 1: Are these identified considerations appropriate? Are there other considerations the Board should incorporate in its evaluation of capital frameworks for supervised institutions significantly engaged in insurance activities?

AIG views the considerations highlighted in the ANPR to be appropriate. We also urge the Board to incorporate among its considerations the potential for alignment of the Federal Reserve's group regulatory capital construct with the ICS, as it evolves, given the attendant benefits of global market access that would be furthered by a globally consistent group capital standard.

We note that there are important conceptual and technical similarities between the current ICS proposal and the development of a consolidated, factor-based approach along the lines that the Board is appropriately pursuing. Notably, the ICS in its current iteration is based on a consolidated view of enterprise capital and risk exposure; relies on the application of factors to determine required capital for many risk types; and provides for a tractable and intuitive approach for incorporating the diversification inherent in the insurance business model across financial and non-financial insurance risks.

To this end, we encourage the Board to assess the elements of the current ICS proposal, including the design and calibration of exposure measures, factors, and correlation assumptions that could serve as a useful basis for the Board's consolidated, factor-based approach. Additionally, the 2015 and 2016 IAIS "field test" provides a valuable and unique source of quantitative data and insight to inform the design and development of the Board's approach. We also see an important opportunity for the Board's work and analysis on the domestic consolidated capital standard to significantly shape the future direction and continuing evolution of the ICS.

Another important consideration is for the Board to calibrate the CA to be alignable with the Board's proposed BBA for non-SIFI insurance groups, with a view to achieving comparable product-specific charges that account for potential differences in valuation basis, definitions of available capital, and segmentation across the two constructs. If there were two capital constructs, we believe that the development of both the CA and building blocks approach (BBA) should proceed in parallel and as part of a closely integrated and deliberative policy development process. An integrated calibration process focused on the comparability of risk charges at an exposure or product level would help to ensure that the CA not impose unwarranted and unintentional regulatory capital constraints relative to the BBA, and vice versa, an undesirable result which would unnecessarily hamper competitive equity and the provision of socially-useful insurance products across a range of markets. In this vein, we also urge the Board to consider the relative calibration between its group capital requirements and extant entity-level jurisdictional risk charges, in order to avoid unintended and potentially distortive risk capital frictions across group-level versus entity-level requirements.

We agree with the Board's consideration that the regulatory capital construct be developed with a view to its future integration with the Board's supervisory stress test regime. It is important that the calibration of a minimum group capital ratio consider the post-stress impact of applying a Federal Reserve stress testing regime, particularly when assessing the alignment of the calibration of the CA with the BBA. AIG views it as essential that the effective capital requirements under the CA, after application of group-wide stress testing and potential (and, in our view, unnecessary) systemic risk capital buffers, not result in product-level charges that are uneconomically onerous and that might hamper the competitive ability of insurance SIFIs to continue the provision of socially-useful products.

Additionally, it is important that the Board's capital regime also co-evolve with FR 2085 group regulatory reporting standards. As one among many examples, the segmentation within FR 2085 creates a potential and desirable basis for differentiating risks in the design of factor-based required capital charges. Premature implementation of a highly granular FR 2085 reporting standard, as proposed, would front-run important technical decisions in the regulatory capital and stress testing rulemaking processes, in ways that could undermine the quality and effectiveness of each.

Question 2: Should the same capital framework apply to all supervised insurance institutions?

For insurance groups with a multi-jurisdictional business model, we agree that it is appropriate to apply a well-designed, rigorously tested, and thoughtfully calibrated consolidated capital approach that is oriented to the diversity of enterprise risks that a multi-line insurer manages; is alignable in future with an evolving ICS; is based on high quality capital; and can be integrated with the Board's group-wide supervisory stress testing and reporting regime. If it were deemed necessary to have a capital framework based on existing jurisdictional requirements, such as the building block construct proposed in the ANPR, it would more appropriately apply to domestically-oriented carriers with more limited product and geographic diversification.

Due to principles of proportionality, it is an essential requirement to develop the approaches in tandem such that the relative calibrations, particularly at a product level, are appropriately aligned in order to mitigate the potential for regulatory rules to drive unwarranted competitive imbalances across carriers.

Question 3: What criteria should the Board use to determine whether a supervised insurance institution should be subject to regulatory capital rules tailored to the business of insurance?

We agree with the Board's objective of ensuring that the capital rules tailored to insurance companies are only applied to institutions whose level of insurance activity is significant, rather than incidental, to the group's overall activities. However, we think it is useful for the Board to apply a measure of context-specific judgment, rather than relying solely on fixed thresholds.

Question 4: If multiple capital frameworks are used, what criteria should be used to determine whether a supervised insurance institution should be subject to each framework?

We agree that the consolidated, factor-based approach is the more appropriate construct for insurance groups that are designated as systemically-important, as well as for groups that are internationally-active. We believe that a well-designed and appropriately calibrated consolidated approach would be an attractive option for carriers beyond those designated as SIFIs, given the potential informational value of a meaningful consolidated regulatory capital approach in managing enterprise risk capital. A consolidated, factor-based approach, if thoughtfully developed and rigorously tested, could be conceptually and technically alignable not only with the IAIS framework, but also with extant industry approaches for estimating and managing internal economic capital on an enterprise basis.

To this end, we encourage the Board to further enhance its differentiation by providing non-SIFI institutions with the discretion to "opt-in" to the consolidated approach. We believe that some institutions would be positively attracted to both the global alignability and native consolidation basis of this approach, provided its ultimate design and calibration is appropriately tailored to the insurance business model and is sufficiently risk-sensitive.

Question 5: In addition to insurance underwriting activities, what other activities, if any, should be used to determine whether a supervised institution is significantly engaged in insurance activities and should be subject to regulatory capital requirements tailored to the business mix and risk profile of insurance?

We agree that the Board's proposal to focus on insurance underwriting activities is reasonable.

Question 6: What are the advantages and disadvantages of applying the BBA to the businesses and risks of supervised institutions significantly engaged in insurance activities?

We believe that, when applied in an appropriate context, the aggregation of entity-level capital requirements can provide a useful lens on an insurance group's capital position. As the basis of group-wide regulatory capital requirements, we think that the BBA can serve as a useful construct, particularly for institutions with less diversified business models that operate in a limited number of jurisdictions with comparable valuation and capital requirements.

AIG, in our assessment of the potential for a group-wide framework to be based on an aggregation of local insurance company requirements, has identified some potential prudential disadvantages with the approach. The process of aggregating local insurance company requirements (which as individual regimes are based on valid and legitimate - but divergent - approaches to valuation, reserving, and risk quantification) does not provide the same informational utility as a meaningful consolidated group-wide assessment of risk capital. AIG notes the following limitations of the BBA, when applied as the basis for enterprise-wide capital requirements at multi-jurisdictional insurance groups:

- **Limited transparency to external stakeholders.** Aggregation across multiple local regimes, which can differ fundamentally in statutory valuation, risk capital approaches, and overall calibration, creates the potential for "noise" rather than "signal" entering the resulting group measure, particularly as local statutory and capital regimes around the world evolve, appropriately, at their own direction and pace in future. The ability for investors and supervisors to readily estimate and understand the aggregated group capital measure requires a deep and continuing technical comprehension of multiple regimes, a wide and diverse array of reserving approaches and permitted practices, and non-trivial calculation efforts.

- **Challenges in stress testing.** The informational limitations of the BBA are likely to be most evident when it matters most – under periods of stress. Divergent regimes across multiple regulatory jurisdictions and countries are likely to vary (in some instances considerably) in their sensitivities to the deterministic stresses applied within the Federal Reserve's stress testing program. This non-linearity in response, owing to jurisdictional differences in both statutory valuation and risk-based capital regimes, would undermine the informational utility of a group's stress test results; for example, the same asset could exhibit substantially different impacts depending on where it is held across the organization. Additionally, since the BBA is unlikely to align with a carrier's internal approach to assessing risk capital on an economic basis, it will have limited utility in promoting qualitative enhancements to internal risk management practices and capital management strategies – cornerstone objectives of the Federal Reserve's group supervision and stress testing program. Finally, during periods of stress, the BBA could create counterproductive incentives for institutions to seek to optimize their aggregated ratios by transferring exposures across entities, without necessarily mitigating or improving the consolidated group risk capital position. This optimization effort could distract resources and energy from identifying "root cause" solutions to enterprise risk capital issues.

- **Engenders unnecessary political friction across regulatory regimes**. The natural and desirable ongoing evolution in local standards in US states and countries around the world would impose a continuing and politically sensitive operational burden on Board policymakers to recalibrate across regimes as local rules change over time. Implementation of the BBA for multi-jurisdictional insurance groups places an onus on the Board to both: (i) make determinations about the relative legitimacy of divergent regulatory regimes across the world; and (ii) devise a continuous calibration mechanism across these regimes that entails (and conveys) implicit judgments about their comparative rigor and quality, all in aid of a goal that is distinct from the legitimate and important regulatory objectives of each of the state and foreign jurisdictions.

Question 7: What challenges and benefits do you foresee to the development, implementation, or application of the BBA? To what extent would the BBA utilize existing records, data requirements, and systems, and to what extent would the BBA require additional records, data, or systems? How readily could the BBA's calculations be performed across a supervised institution's subsidiaries and affiliates within and outside of the United States?

Question 8: What scalars and adjustments are appropriate to implement the BBA, and make the BBA effective in helping to ensure resiliency of the firm

and comparability among firms, while minimizing regulatory burden and incentives and opportunity to evade the requirements?

Question 9: To what extent is the BBA prone to regulatory arbitrage?

AIG believes, based on our internal assessment of proposed approaches akin to the BBA, that there are inherent technical challenges in aggregating jurisdictional capital requirements across disparate valuation, reserving, and risk quantification regimes. This basis in disparate regimes creates the potential for regulatory arbitrage, which can be partially, but not comprehensively, addressed through the development of scalars across regimes. However, the development of scalars would introduce significant technical and operational complexity to the BBA. AIG is concerned about the following challenges in the development of the BBA:

- **Challenges in calibration of scalars.** The creation and calibration of scalars to put diverse jurisdictional regimes on a more consistent footing would impose on regulators a need to assess and align multiple divergent statutory valuation, available capital, and risk quantification frameworks globally. Additionally, regulators would need to dynamically recalibrate these scalars over time, as jurisdictional requirements evolve at their own pace and direction. Examples of jurisdictional evolutions that would require further recalibration by the Board include: the development of new, or recalibration of existing, required capital charges; changes in statutory valuation and reserving practices; or changes in local minimum standards.

- **Challenges in achieving sufficiently granular scalars.** In order to deter regulatory arbitrage, such as the decision to book an asset or activity in a specific jurisdiction for the purpose of reducing regulatory capital requirements without attendant economic risk mitigation benefits, the scalars developed by the Board would need to apply at a granular asset class or product level. For example, even the application of "top-down" scalars at an entity level would still leave open the potential for significant differences in regulatory capital charges across jurisdictions for the same underlying risk exposure. However, the design of an extensive and meaningful exposure-level system of cross-jurisdictional scalars to mitigate the potential for regulatory arbitrage would involve significant analytical resources and, in turn, would undermine the computational tractability and transparency of the BBA ratio.

- **High intensity of computational effort for multi-jurisdictional insurance groups.** We believe a misconception underlying the BBA is that it is a readily and easily implementable construct. Although the underlying building blocks of the calculation (i.e., the local jurisdictional valuations, capital definitions, and required capital approaches) are already calculated for local requirements and therefore available as inputs to the BBA, these inputs require additional modification and adjustment in order to be aggregated in a coherent manner as the basis for group regulatory capital requirements. For example, some intercompany transactions, including those transactions conducted among operating entities and between the parent holding company and subsidiaries, would need to be unwound to avoid the double-counting of capital resources at the entity level. Additionally, the BBA could potentially require a revaluation of statutory reserves in order to neutralize the regulatory capital incentives for institutions to deploy captive structures and other reserve reduction techniques. These types of adjustments are technically feasible to perform, but require significant additional recalculations that would result in a group BBA ratio that in some instances can represent a significant departure from the underlying building blocks.

Question 10: Which jurisdictions or capital regimes would pose the greatest challenges to inclusion in the BBA?

In AIG's view, the following are potential challenges in aggregating across disparate regimes:

- **Statutory reserving practices across US states.** The differences in permitted and prescribed practices across state jurisdictions, and the use by some institutions of captive structures to address perceived conservatism in life insurance statutory reserves, creates potential inconsistencies when comparing statutory reserves across operating entities from different states. It is, in our view, appropriate that individual state authorities establish statutory reserving standards in a manner that is meaningful and supportive of their supervisory objectives. However, the resulting differences across certain jurisdictions, and the use of reserve management techniques such as the creation of captives, impose challenges in assessing the quality of reserves (and, in turn, of available capital) from state to state.

- **International differences in valuation practices.** Current differences in valuation practices globally, including whether to apply best estimate assumptions and the approach to discounting, are an important focus of current IAIS standard-setting efforts. Establishing greater harmonization in valuation practices is a worthwhile and, with effort, an achievable objective for the industry over the next several years and is essential to the goal of a more convergent global capital standard. However, valuation is an issue that requires coordinated and dedicated work by industry and policymakers in concert, and which a scalar or targeted adjustment cannot readily solve at present.

- **International differences in model-based vs. factor-based methodologies.** An important distinction globally is that national regulators in some cases vary significantly in their use of models as the basis for determining required capital. Most notably, while some prominent regimes, including the US state-based system, primarily apply factor-based approaches to required capital, many other regimes, most prominently Solvency II, rely extensively on enterprise-wide economic capital models. Although it is technically feasible to align the calibration of factor-based (e.g., NAIC model law) and model-based (e.g., Solvency II) approaches at a specific point-in-time, the relative sensitivities of these approaches will vary across the economic cycle, which would entail a dynamic (and resource-intensive) recalibration of the corresponding scalars.

Question 11: How should the BBA apply to a supervised institution significantly engaged in insurance activity where the ultimate parent company is an insurer that is also regulated by a state insurance regulator? Are there other organizational structures that could present challenges?

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Question 12: Is the BBA an appropriate framework for insurance depository institution holding companies? How effective is the BBA at achieving the goal of ensuring the safety and soundness of an insurance depository institution holding company?

Question 13: Would the BBA be appropriate for larger or more complex insurance companies that might in the future acquire a depository institution?

Question 14: In applying the BBA, what baseline capital requirement should the Board use for insurance entities, banking entities, and unregulated entities?

AIG believes that one of the challenges of the BBA is to design and calibrate appropriate capital requirements for the portions of the consolidated group that are not currently subject to jurisdictional insurance company capital requirements. For example, applying a capital treatment based on Basel III at the parent holding company implies that an insurance parent holding company serves a similar purpose and function as, and has a similar risk profile to, the holding company of a banking organization.

Additionally, the application of Basel III asset charges at parent – which were designed based on a banking business model and do not necessarily reflect the financial risk exposure of an insurance group with a stable liability profile – could incentivize the transfer of assets between parent and operating entities in a way that is designed to minimize group regulatory capital requirements under a BBA construct. A consolidated approach, by contrast, would treat the same risk exposure in an identical manner across the organization, in turn obviating these types of incentives.

We agree that, under the BBA, it is sensible to apply a Basel III capital treatment for banking activities. The proper treatment of parent holding company exposure is a more complicated issue, and the blanket application of Basel III methodologies and assumptions is not necessarily appropriate, given both the potential for incentivizing regulatory-driven asset allocations across the group and the differences in insurance versus banking holding company management.

Question 15: How should the BBA account for international- or state-regulator-approved variances to accounting rules?

Question 16: What are the challenges in using financial data under different accounting frameworks? What adjustments and/or eliminations should be made to ensure comparability when aggregating to an institution-wide level?

Question 17: What approaches or strategies could the Board use to calibrate the various capital regimes without needing to make adjustments to the underlying accounting?

Under the BBA, it is inevitable that a multi-jurisdictional insurer – even one that is domestically-oriented but operating across multiple states – will face different valuation and accounting practices from one jurisdiction to another, in turn affecting its resulting BBA ratios. For example, differences in liability valuation across jurisdictions affect the amount of available capital that would be generated under each framework. These differences are often grounded in the underlying actuarial valuation approaches in each jurisdiction, are complicated by the usage by some groups of captive structures, and are not readily alignable through simple and tractable adjustments.

At the same time, AIG believes that it is not a worthwhile exercise to extensively restate the respective statutory valuations on a more consistent basis for the sole purpose of generating a BBA ratio. Indeed, restatement would, in effect, place an undue onus on the Board, if it is not to cede its direct statutory mandate to state and foreign regulators with different prudential goals, to make relative assessments of, and modifications to, existing state and foreign approaches to reserving and permitted practices. It is also notable that the potential desirability for such restatement further belies the view that the BBA is a readily implementable group capital construct for multi-jurisdictional insurance groups.

Question 18: How should the BBA address intercompany transactions?

Within a BBA construct, the unwinding of intercompany transactions should be focused on preventing the potential double-counting of capital, such as the down-streaming of debt issued at the parent to help capitalize operating subsidiaries.

The use of intercompany reinsurance, particularly if ceding risk exposure to a well-established jurisdiction in a manner that enhances economic diversification, does not in any way undermine the assessment of enterprise risks on a group basis. Therefore, these activities should not be unwound in the BBA calculation, particularly since the application of scalars would help to promote a basic "top-down" alignment across major jurisdictional regimes.

Question 19: What criteria should be used to develop scalars for jurisdictions? What benefits or challenges are created through the use of scalars?

In AIG's view, the development and application of scalars is laden with several technical challenges, in particular:

- reconciling across disparate valuation regimes, particularly the estimation of reserves in various jurisdictions;

- aligning the outcomes from factor-based versus model-based methodologies, which tend to have differing sensitivities under changing financial and economic conditions; and

- recalibrating dynamically to reflect continuing justifiable but unavoidable future evolution in jurisdictional valuation and required capital standards.

We also urge the Board to consider the political challenge that is inherent in the development of scalars – namely, the implicit (and even explicit) judgments that the Board would be required to make about the array of jurisdictional valuation and risk quantification approaches both domestically across states, as well as internationally. With the process of developing scalars, the Board would in effect become a global arbiter of the relative quality of insurance actuarial practices and regulatory approaches globally.

In designing scalars, which are a technically and politically undesirable, but perhaps ineluctable, aspect of building a viable BBA, the following criteria may be useful:

- Calibration based on a "total assets required" or "TAR" concept, to help control for differences in liability valuation across institutions and across regimes;

- Consideration of differences in sensitivity of the various underlying regimes to stress conditions (i.e., avoiding undue reliance on a current point-in-time assessment of these regimes); and

- Selection of an appropriate and meaningful cohort of insurance groups (e.g., similar risk profiles and diversity of businesses) in estimating the scalars.

Question 20: What are the costs and benefits of a uniform, consolidated definition of qualifying capital in the BBA?

Question 21: If the Board were to adopt a version of the BBA that employs a uniform, consolidated definition of qualifying capital, what criteria should the Board consider? What elements should be treated as qualifying capital under the BBA?

Question 22: Should the Board categorize qualifying capital into multiple tiers, such as the approach used in the Board's Regulation Q? If so, what factors should the Board consider in determining tiers of qualifying capital for supervised institutions significantly engaged in insurance activities under the BBA?

We believe that a consolidated definition of qualifying capital could enhance the coherence of the BBA and its amenability to the Federal Reserve's stress testing program. Additionally, a consolidated definition would facilitate a more consistent and integrated approach to determining available capital resources, which can vary, in some cases significantly, across the underlying jurisdictional capital regimes.

An important consideration in designing a consolidated capital definition for the BBA is that the valuation basis for required versus available capital would differ. The challenge for the Board will be to ensure that the component jurisdictional capital charges, which in many instances were developed in relation to the corresponding statutory definitions of reserves and capital, generate logical and appropriate required capital amounts when aggregated across the disparate jurisdictions. For example, a jurisdiction that applies relatively more conservative reserving standards might, as an offset, apply a relatively less conservative calibration to required capital. If the Board were to define available and required capital on differing valuation bases, then these and similar nuances will be important to capture in the BBA calibration process.

The decision of whether to base the BBA on a consolidated definition of available capital creates a tradeoff with respect to potential tiering of capital. On the one hand, a consolidated approach to available capital would allow the Board greater flexibility in defining both the forms and relative loss absorption of potential capital elements, including potential adjustments to certain items such as intangibles. Relying on extant statutory definitions of available capital would not confer similar flexibility. On the other hand, a consolidated approach could create potential asymmetries with the definition of required capital, which would be based on the localized statutory valuation, reserving, and risk quantification approaches.

AIG thinks it is important that the Board design a capital standard that is grounded in high quality forms of capital that provide loss absorption on a going concern basis for the consolidated enterprise. We believe that a critical hallmark of a successful group regulatory capital regime will be its ability to provide informational utility to external stakeholders, who rightly focus on an institution's most available and credible forms of capital during periods of stress.

Additionally, we urge the Board, as a critical element of tailoring its requirements to the insurance business model and risk profile, to assess the degree of loss absorption provided by the spectrum of available capital components. For example, the potential realization of DTA under conditions of economic stress could differ for an insurance group with diversified financial and non-financial risks, relative to a banking organization concentrated in financial risk. We believe this potential difference in DTA realization under stress merits further economic and empirical analysis.

While we urge the Board to focus on high quality forms of loss absorption as the basis of its insurance group regulatory capital requirements, we believe that there could be some limited scope for a secondary tier of capital that is designed and intended to absorb losses on a "gone concern" basis. The limited prudential utility of a secondary, "gone concern" tier of capital owes to the insurance resolution model, which is more deliberate than the banking resolution process and, in turn, less reliant on sizable and immediate injections of capital for funding the run-off of operations and liabilities. Importantly, insurance groups typically rely far less on short-term wholesale funding than banks. Insurers therefore do not require the same degree of "capital in resolution" (e.g., "gone concern" capital and "total loss absorbing capacity") as banks need for deterring runs by holders of runnable liabilities.

Question 23: What are the advantages and disadvantages of applying the CA to the businesses and risks of supervised institutions significantly engaged in insurance activities?

AIG supports the CA as the basis for the Board's development of group-wide regulatory capital requirements, and we see several potential advantages, notably:

- A coherent and comprehensive treatment of risk exposures across the enterprise, including the transparent, tractable, and consistent aggregation of risks in a manner that recognizes the demonstrable risk diversification across an insurance group's financial and non-financial risks;

- Mitigation of intra-group regulatory arbitrage, by treating risk exposures in a consistent manner irrespective of the entity or jurisdiction in which the asset or liability is boarded;

- A pathway for alignment, and an opportunity for intellectual cross-fertilization, with the international capital standard that the IAIS is in process of developing;

- Integration with the Board's group-wide stress testing, regulatory reporting, and group supervision objectives, which are all grounded in a consolidated view; and

- Conceptual and technical consistency with evolving insurance group approaches to economic assessments of liability valuation and enterprise-wide risk capital, supporting a "use test" that is critical to validation and integration of the regulatory capital construct within enterprise risk and financial management.

Although AIG does not see significant conceptual disadvantages to the CA as a construct, we also understand that the proposed construct is at a formative architectural stage and that meaningful work is necessary in future to achieving a fully-specified and tailored group capital framework. We support the Board in its commitment to a deliberative policy process grounded in the evidence-based work and careful judgment that will be necessary to developing thoughtful methodologies for determining required and available capital, as well as to producing a calibration that is economically reasonable, risk-sensitive, and alignable with both the BBA and ICS, as each construct evolves.

Indeed, the desirable prudential objective of building a well-designed CA will require thoughtful deliberation, iterative public consultation, and rigorous quantitative analysis and testing, leveraging not only the ongoing and future field testing exercises being coordinated by the IAIS but also appropriately designed QIS exercises, a process that was fundamental to the Board's development of banking capital standards.

Question 24: What are the likely challenges and benefits to the development, implementation, and application of the CA? To what extent could the CA efficiently use existing records, data requirements, and systems, and to what extent would the CA require additional records, data, or systems?

The primary challenge in developing the CA is to build and test the design, methodology, and calibration of what will be an innovative group capital standard. We believe that the Board, in developing the CA, should, to the extent feasible, leverage readily available GAAP-based financial and actuarial information, which will facilitate both ease of implementation and transparency to external stakeholders.

To facilitate the development of the CA, we also urge the Board to draw from, and build on, other existing frameworks that rely in whole or in part on a factor-based approach to required capital, including for example US RBC / NAIC model law, the evolving ICS proposals, and well-accepted industry approaches. For example, both the US RBC and ICS frameworks apply a tractable, formulaic approach to explicitly incorporating diversification effects across risks – an approach that can be readily implemented as part of the CA. An important focal point for incorporating diversification in this manner will be the granularity and calibration of the underlying correlation parameters, which in our view should be based on a combination of empirical study, prudent expert judgment, and a consideration of the positive behavioral incentives for institutions to mitigate risk concentrations.

The design of a factor-based approach to required capital on a consolidated basis encompasses the following foundational elements:

- **Segmentation of products and activities.** The starting point is to differentiate an insurer's products and activities into clearly identifiable segments, with homogenous risk exposure and similar risk-sensitivity. We believe it is important that the Board's approach to segmentation co-evolve with the recently proposed FR 2085 for insurance SIFI consolidated reporting. The segmentation within FR 2085, as it evolves, creates a potential and desirable basis for differentiating risks in the design of factor-based required capital charges.

- **Measure of exposure**. The Board's choice of exposure measure should reflect the underlying risk profile of the specific product or activity. The appropriate measure is one that is amenable to linear application of factors that will generate a directionally appropriate and comparable quantum of risk capital across products. In AIG's view, it is desirable for the Board to apply exposure measures that are readily accessible and available. It is not necessary, however, for the Board to source all of its exposure measures directly from GAAP balance sheets; optimally, measures will vary across products, depending on their suitability.

- **Factor calibration.** The calibration of the individual risk factors should be anchored in the Board's overall target calibration, needs to reflect the interplay of stand-alone risk charges with correlations in reflecting enterprise-wide diversification, and must consider the cumulative effective capital requirements after taking into account both potential additional capital buffers and the application of stress testing. A factor calibration that might appear appropriately risk-sensitive within the underlying CA capital ratio can become uneconomical once additional buffers and stress test requirements are applied ex post.

Question 25: To what extent would the CA be prone to regulatory arbitrage?

By applying a consistent measure of risk exposure across the enterprise, the CA mitigates the potential for regulatory arbitrage. In this respect, the CA helps to ensure that differences in product-level jurisdictional capital requirements, which in some cases are significant, are not enshrined in a group-wide capital requirement.

Question 26: Is the CA an appropriate framework to be applied to systemically important insurance companies? What are the key challenges to applying the CA to systemically important insurance companies? How effective would the CA be at achieving the goals of ensuring the safety and soundness of a systemically important insurance company as well as minimizing the risk of a systemically important insurance company's failure or financial distress on financial stability?

We believe that a well-designed CA can serve as a viable group regulatory capital framework for systemically important insurance companies, given its consistent treatment of risk exposures across the enterprise; more coherent assessment of group-wide risk exposure and capital adequacy; complementarity with extant capital requirements for operating legal entities; pathway for alignment with, and concomitant influence on, a more evolved ICS; promotion of cross-jurisdictional comity and market access; and integration with the Board's group-wide stress testing, regulatory reporting, and group supervision objectives, which are principally anchored in a consolidated enterprise view. Indeed, we believe that some institutions that are not designated as SIFIs would be positively attracted to both the global alignability and native consolidation basis of the CA, and we encourage the Board to further enhance its differentiation by providing non-SIFI institutions with the discretion to "opt-in" to the consolidated approach.

The CA's utility and viability as a group regulatory capital framework will depend in large part on the Board's ability to design and calibrate requirements based on:

- Asset risk charges that consider the more stable funding profile of insurance companies relative to banks;

- Insurance risk charges that reflect the immaterial contribution to systemic risk of many insurance activities, particularly for non-life; and

- Risk aggregation that incorporates the significant and demonstrable diversification generated by non-financial insurance activities.

The appropriate incorporation of an insurance group's diversification across financial and non-financial risks is a critical design element for a viable CA that is economically-sensitive and promotes sound prudential management of concentration risks.

The meaningful recognition of insurance group diversification is fundamental to the tailoring principle. Certain risks, in particular the intra-financial risks that are central to a banking business model, tend to be driven by similar risk factors and should be aggregated assuming relatively higher correlations. However, for insurance groups, the potential losses from financial shocks (e.g., market downturns) and insurance-related stresses (e.g., natural or man-made catastrophes; mortality) are much less likely to manifest simultaneously.

Incorporating differentiated estimates of correlation – where based on empirical study, sound analysis, and documented experience - is therefore instrumental to aggregating an insurance group's required capital and, in turn, promotes: (i) the credibility of regulatory capital standards, through closer alignment with underlying economic risk (an important aspect of a regulatory "use test"); and (ii) prudential and economic incentives to mitigate risk concentrations, deter regulatory arbitrage, and provide socially-useful products with low correlations to the rest of the portfolio.

Methodologically, we believe that, to achieve these objectives, the CA must incorporate differentiated correlations explicitly in the aggregation of required capital across risk types. Explicit correlation recognition provides greater transparency into the impact of diversification on enterprise-wide risk exposure and promotes more defined behavioral incentives for insurers to actively identify, assess, and mitigate their risk concentrations. Explicit diversification is achievable through a simple, tractable, and risk-sensitive formulaic methodology, comparable to the current proposed approach within the ICS.

We also believe that regulatory capital approaches to aggregating insurance (liability-side) risks with financial (asset-side) risks should be based on reasonable but conservative correlation values that reflect:

- The inherent uncertainty in statistical estimation of certain relationships;

- The potential for higher correlations under stress, which is significant for aggregating intra-financial risks but not as relevant for aggregating financial risks with non-financial insurance risks; and

- That certain insurance products (e.g., variable annuities) are relatively more sensitive to financial risk factors than others, and others less so.

Question 27: What should the Board consider in determining more stringent capital requirements to address systemic risk? Should these requirements be reflected through qualifying capital, required capital, or both?

In AIG's view, the integration of the CA with Federal Reserve stress testing, which is more readily achievable given the consolidated basis of the CA, is a more effective and dynamic mechanism than a potentially crude capital buffer in addressing supervisory concerns about potential systemic risk. Stress testing enables a forward-looking, contextual assessment of the sensitivity of an institution's risk profile and capital position to a scenario that can be tailored to the firm's and the Federal Reserve's modal concerns about significant systemic risk factors and market conditions. This exercise provides an informationally richer and more focused approach to addressing systemic risk than a blunt capital add-on.

Question 28: What should the Board consider in developing a definition of qualifying capital under the CA? What elements should be treated as qualifying capital under the CA?

Question 29: For purposes of the CA, should the Board categorize qualifying capital into multiple tiers? What criteria should the Board consider in determining tiers of qualifying capital for supervised institutions significantly engaged in insurance activities under the CA?

As noted previously, we believe it is important that the Board design a capital standard that is grounded in high quality forms of capital that provide loss absorption on a going concern basis for the consolidated enterprise. We believe that a critical hallmark of a successful group regulatory capital regime will be its ability to provide informational utility to external stakeholders, who rightly focus on an institution's most available and credible forms of capital during periods of stress.

In defining an appropriate definition of high quality capital, it is important for the Board to assess the relative loss absorption of the components of capital. For example, we believe that the degree of DTA recognition within "going concern" capital should be based on stress testing to assess asset recoverability and loss absorption. We view the stress testing process as a more risk-sensitive mechanism for assessing DTA loss absorption during financial stress scenarios than the application of hardwired caps and limits on the underlying capital ratio. Additionally, the potential realization of DTA under conditions of economic stress could differ for an insurance group with diversified financial and non-financial risks, relative to a banking organization concentrated in financial risk. This potential difference in DTA realization under stress merits further economic and empirical analysis.

While we urge the Board to focus on high quality forms of loss absorption as the basis of its insurance group regulatory capital requirements, we believe that there could be some limited scope for a secondary tier of capital that is designed and intended to absorb losses on a "gone concern" basis. The limited prudential utility of a secondary, "gone concern" tier of capital owes to the insurance resolution model, which is more deliberate than the banking resolution process and, in turn, less reliant on sizable and immediate injections of capital for funding the run-off of operations and liabilities. Importantly, insurance groups typically rely far less on short-term wholesale funding than banks, and therefore do not require the same degree of "capital in resolution" (i.e., "gone concern" capital or "total loss absorbing capacity") to stall runs by holders of runnable liabilities.

Question 30: What risk segmentation should be used in the CA? What criteria should the Board consider in determining the risk segments? What criteria should the Board consider in determining how granular or risk sensitive the segmentation should be?

Question 31: What challenges does U.S. GAAP present as a basis for segmentation in the CA?

Question 32: What are the pros and cons of using the risk segmentation framework in the proposed Consolidated Financial Statements for Insurance Systemically Important Financial Institutions as the basis of risk segmentation for the CA?

Question 33: How should the CA reflect off-balance-sheet exposures?

Within a factor-based approach, segmentation is the primary mechanism for differentiating risks across products and activities. Segments should encompass products and activities with homogenous risk exposure and similar risk-sensitivity. Developing sufficiently granular, but still tractable, segmentation is therefore an essential design consideration.

To the extent that the Board adopts an evolutionary approach to the CA, with more basic segmentation in the initial implementation followed by subsequent refinement and evolution as the framework matures, AIG believes it is essential that the initial calibration be concomitantly modest and alignable with the product-specific risk charges within the BBA. If applying a broad initial segmentation, with a range of products and exposures grouped in the same risk category, the Board should be cautious in ensuring that the resulting factors applied do not result in the inadvertent over-calibration of risk charges on products that are relatively low risk. We believe this consideration is particularly relevant for non-life exposures that are demonstrably uncorrelated with financial risk factors and therefore non-systemic in nature.

We believe that a program of enterprise-wide stress testing, whether conducted as part of an internal management discipline or as part of formal Board requirements, further supports an initially modest factor calibration. Stress testing can help to compensate for potentially diminished risk-sensitivity in a factor-based approach and reduces the reliance on point-in-time factor calibrations to serve as the sole basis of capital adequacy.

We believe that US GAAP does not present significant challenges as the basis for CA segmentation, and that the CA segmentation ought to be carefully aligned with the Consolidated Financial Statements for Insurance Systemically Important Financial Institutions that the Board is in process of developing. We view linkage of the CA and consolidated regulatory reporting requirements as essential to a successful policy outcome for establishing effective and coherent prudential standards and believe it is essential that the policy development process for both capital and reporting requirements is a fully integrated initiative.

We believe that material risks not captured on-balance-sheet should be addressed within both the BBA and CA capital constructs, whether by adjustment to capital resources or through an additional capital requirement. There is precedent in several existing capital frameworks (e.g. NAIC RBC) for reflecting off-balance-sheet adjustments for risks such as off-balance-sheet securities lending, non-controlled assets, contingent liabilities, and pension deficits. Additionally, we see an important potential role for Federal Reserve stress testing in helping to capture certain off balance sheet exposures, if such exposures were challenging to quantify tractably within a discrete capital ratio.

Question 34: Under what circumstances should U.S. GAAP be used or adjusted to determine the exposure amount of insurance liabilities under the CA?

We believe that, as a general principle, the derivation of exposure measures from GAAP financials confers several benefits, including transparency and an anchoring to audited financial results. It is not necessary, however, for the Board to source all of its exposure measures directly from GAAP balance sheets; optimally, measures will vary across products, depending on their suitability. We note that this principle is consistent with the Board's approach to the regulatory capital requirements for banking institutions, which are generally GAAP-based but differ where appropriate (e.g., trading book requirements) to assess the underlying risk exposure in a more economically-sensitive and appropriate manner.

Additionally, we believe that future evolution of valuation standards towards a best estimate liability (BEL) approach, consistent with the market-adjusted valuation basis underlying the proposed IAIS group capital standards, could enhance the practicality of using reserves as an exposure measure for determining factor-based capital charges.

Question 35: What considerations should the Board apply in determining the various factors to be applied to the amounts in the risk segments in the CA?

Question 36: What challenges are there in determining risk factors for global risks?

As noted previously, AIG believes it is essential that the implementation of the CA not impose unwarranted and unintentional regulatory capital constraints relative to the BBA, which would unnecessarily hamper competitive equity and the provision of socially-useful insurance products across a range of markets. This assessment of the relative calibration across these two constructs must consider the impact of Federal Reserve stress testing on the "all-in" effective capital requirements for specific products and risk exposures.

The appropriate choice of an exposure measure, to which the factors would be applied, is one that is amenable to linear application of factors that will generate a directionally appropriate and comparable quantum of risk capital across products. Therefore, for certain insurance risk exposures (e.g., low frequency / high severity risk factors; complex optionality), it could be appropriate to apply model-based approaches selectively, subject to appropriate controls and oversight.

An additional and important consideration is that, for certain enterprise risks, capital requirements are not necessarily the optimal mechanism for assessing and mitigating the risk. For example, interest rate risk is more suitably addressed through supervisory tools focusing on, and incentivizing, ALM and cash flow matching, rather than through an explicit capital charge that, in a factor-based approach, might provide relatively crude approximations of risk. Additionally, interest rate scenarios are an important element of Federal Reserve stress testing, which would reflect the impact of the given stress on asset and liability valuations and available capital.

In this respect, there is strong precedent in the evolution of the Basel capital framework for banking institutions, which has attempted at several points during the past several decades to develop an explicit interest rate risk charge for the banking book, without ultimately succeeding in implementing a tractable capital requirement.

In the development of the CA, we note several compelling reasons to not explicitly incorporate an interest rate risk charge within the group-wide capital requirements:

- Insurers' long-established discipline of managing asset and liability maturity profiles reduces exposure to short-term asset market volatility. This discipline is additionally reinforced by cash flow testing requirements employed by various insurance subsidiary regulators.

- Insurance companies provide liquidity transformation at the longer-end of the maturity curve, whereas banks (which, as noted above, are not subject to a banking book interest rate risk charge) provide transformation at shorter maturities. For some insurance lines, the duration of the liability might in practice exceed that of the fixed income assets backing the liability.

- Insurance companies are, in turn, much less exposed than banks to risks stemming from holding long-term assets backed by short-term wholesale funding, which is the catalyst for illiquidity-driven asset "fire sales" that lie at the heart of regulatory concerns about systemic risk.

- Moreover, given the cash flow-oriented approach of insurance companies, which generally invest in long-term assets in order to defease long-term insurance liabilities, risks arising from the potential mismatching of assets and liabilities are likely to manifest progressively over the course of several years, rather than in an immediate, unexpected stress event.

Question 37: What criteria should the Board consider in developing the minimum capital ratio under the CA and a definition of a "well-capitalized" or "adequately capitalized" insurance institution?

AIG believes that the Board must consider the impact of group-wide stress testing in calibrating its minimum ratio requirements. A well-designed and risk-sensitive enterprise stress testing framework obviates the need for additional capital buffers, such as the Higher Loss Absorbency concept within the IAIS standards, by providing a dynamic view of the potential sensitivity of an insurer's capital position to systemic risk scenarios.

Question 38: Should the Board reevaluate any of these approaches? What additional consideration, if any, should the Board give to any of the regulatory capital approaches discussed above?

AIG looks forward to engaging with the Board as it further develops its proposals on group regulatory capital requirements, and we re-emphasize the fundamental importance of a calibration process that is evidence-based, risk-sensitive, and focused on the relative alignment of product-specific risk charges across the proposed constructs.