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Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

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

Dear Chair Yellen:

These comments are submitted on behalf of the American Council of Life Insurers (the "ACLI"), a Washington, D.C.-based trade association with approximately 280 member companies in the United States and abroad and representing 95 percent of industry assets.[1] We appreciate the opportunity to respond to the Federal Reserve Board's (the "Board") advance notice of proposed rulemaking ("ANPR") on capital requirements for supervised institutions significantly engaged in insurance activities.

Our comments on the ANPR are presented in three parts. First, we present general commentary on the Board's suggested approach, including the possible development of two different insurance group capital regimes. Second, we provide substantive responses to specific aspects of the ANPR, which includes focusing on the questions raised by the Board throughout the proposal. The final section briefly addresses the need to tailor the implementation of any insurance group capital standard to the daily operations of insurance enterprises. We are happy to provide follow-up commentary to the Board on any of these points moving forward.

I. *General Response to the ANPR's Proposed Approach*

The ANPR proposes to promulgate an insurance group capital framework that accurately reflects the unique business and financial structure of insurance companies. We commend the Board on this directional approach. The insurance industry is significantly different from other financial services sectors, and any insurer capital solvency framework must be specially tailored to reflect the industry's business model. We support the Board's efforts to develop a framework that is appropriately tailored for

[1] The ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States.

insurers, and its recognition that the existing state-based insurer financial and solvency oversight regime is appropriate for this purpose.

We do not, however, believe it is necessary to enact two separate capital standard regimes for those insurers under the Board's regulatory purview. Given the Board's stated intention of developing and implementing an insurance-focused capital regime, it should focus solely on the development of the proposed Building Block Approach ("BBA") as its capital framework. As outlined in the ANPR, the BBA is founded on strong, time-tested financial, accounting and solvency standards specific to insurers.[2]

We also believe the capital framework should be consistent with the following principles. It should rely on audited financial statements (or inputs into these statements). It should be tailored to reflect in a risk sensitive manner the unique insurance risk profile, in particular the long-term duration of life protection and savings products. It should capture all material entities and insurer risks. It should measure assets and liabilities in a consistent manner. It should be comprehensive, consistent, and provide a basis for comparison across institutions. And, importantly, it should be able to be implemented in a mature state within 1-2 years so institutions can appropriately adjust their businesses as necessary in response to the framework.

By building on these principles and incorporating them into a holistic framework, the Board correctly proposes to establish a sound supervisory regime appropriate to insurance groups that gives the Board the regulatory tools and insight necessary to carry out its regulatory responsibilities. For these reasons we believe the BBA is the most suitable methodology to apply to all insurance entities subject to the Board's regulatory oversight, regardless of their differences in corporate structure or complexity.

Compared to the BBA, the foundational elements of the ANPR's proposed Consolidated Approach ("CA") are undeveloped. While a CA that is anchored in GAAP, with appropriate adjustments, can be a viable basis for a capital standard, it would require extensive development, review and field testing of insurance risk and associated capital requirements before it could be considered as a suitable or effective regime for targeted firms.

Further, we disagree with the suggestion that the BBA is unsuitable for insurers that have been designated as systemically significant ("SIFI") by the Financial Stability Oversight Council ("FSOC"). As we discuss in greater detail below, the BBA can accommodate insurance groups of any size, organizational structure, global span, and associated "internal and external complexity," as well as the non-insurance activities/entities within the group. In particular, the ANPR exaggerates the complexity of and difficulties involved in applying BBA to insurance SIFIs with respect to:

(i) Size, which is generally a risk diversifier in insurance, unlike in banking;

(ii) "Substantial international operations," as a significant majority of U.S. insurer assets are located in the U.S. or are addressed through the application of BBA scalars which address the risk of arbitrage;

(iii) "Complex organizational structures," as the complexity of the insurance SIFIs is not meaningfully greater than that of many other insurers. Furthermore, the organizational structure of an insurance group is generally driven by the relative separation of different activities by type and jurisdiction into different legal entities, which is in part a function of the state based regulatory system, and in our view does not denote complexity. This type of structure actually reduces complexity in many respects, both in terms of risk measurement for each legal entity and in terms of avoiding the spreading of hypothetical

[2] Although the majority of ACLI member companies, including those currently supervised at the group level by the Board, support a BBA-only approach, one ACLI member, AIG, has voiced a different view. The Board will likely hear directly from AIG on its position.

distress from one entity to the next. This makes it crucially important for the right amount of capital to be held in the right entity rather than for extra capital to be held elsewhere. BBA adjustments will address and accommodate different organizational structures in any event.

(iv) "Non-insurance operations," which are not material for insurance SIFIs. Asset management is the primary form of insurers' non-banking, non-insurance activity – and the FSOC has determined that asset management entities are not systemic and can be handled via an activities-based approach. In any case, the BBA can address non-insurance operations through identification and assignment of appropriate capital regimes to non-insurance entities and transparency to supervisors.

The BBA is entirely viable for insurers whether or not they are designated as systemically important and provides both the tools and transparency necessary to allow the Board to guard against any perceived risks of arbitrage or double leverage in any institution under its oversight. In addition, we believe the capital stress testing provision of the Dodd-Frank Act provides ample additional Board authority over SIFI designated companies. Similarly, we think an institution's systemic risk, if any, is captured through the Board's extensive regime of liquidity regulation, which is currently the subject of a separate NPR.[3] Also, the application of BBA to all supervised insurers enhances comparability and eliminates the regulatory burden associated with developing and maintaining a CA in addition to the BBA. For these reasons we believe that a separate and likely more burdensome group capital regime than that applied to other Board regulated insurers is not warranted.

Further, we believe it is crucial that the Board conduct a quantitative impact study ("QIS") in advance of developing a proposed rule on a group capital standard for insurance institutions under its purview. As the Board recognizes in the ANPR, the insurance industry's business model presents unique differences compared to other financial institutions with which the Board is historically familiar. This fact necessitates that the Board work deliberately and painstakingly to gather and understand all relevant information about the business and financial operations of the insurance institutions it supervises prior to developing a relevant group capital standard. We believe a QIS will greatly enhance the Board's knowledge and understanding of the industry in this regard. We further believe that a QIS conducted in respect of the BBA, which would likely primarily focus on the proposed adjustments that may be needed to calculate the group capital requirement, could be performed within the short-to-medium term timeframe desired by the Board. Given the relatively undeveloped and more ambitious nature of the CA, however, we believe a lengthier and more involved QIS and field testing process would be necessary if the Board continued to pursue that approach.

Last, we think it is important that the Board provide supervised entities with its expected timeline for the development, proposal, promulgation and implementation of any insurer group capital standard. We believe this is necessary to ensure that the effected institutions have as much time as possible to fully prepare and adopt appropriate business plans to ensure their ability to comply with these new requirements.

In sum, we encourage the Board to focus solely on the development of the BBA rather than spend additional time and resources to develop the yet-to-be-defined parameters of the proposed CA, request that the Board conduct a QIS of the potentially effected supervised companies prior to developing an insurer capital standard, and ask that the Board publish its expected timeline for development, adoption and implementation of any such standard so effected companies can plan accordingly.[4]

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[3] Enhanced Prudential Standards for Systemically Significant Insurance Companies, 81 Fed. Reg. 38610 (proposed June 14, 2016).

[4] In the event the Board determines to pursue the CA for insurance SIFIs, the Board should initially apply the BBA to those companies until such time as the CA has been sufficiently refined and comprehensively field tested, well beyond the blunt instrument described in the ANPR. This would not only avoid any unintended consequences of applying an unrefined CA but

II. *Discussion of the Specific Proposals and Questions Presented by the ANPR*

A. Important Considerations Regarding an Insurance Regulatory Capital Framework

Insurance entities doing business in the U.S. are highly regulated enterprises. The existing regime of insurance financial and solvency regulation is intended to protect policyholders and decrease the risk companies could pose to the financial system. Insurers are subject to strict capital requirements which operate not only to mandate a minimum capital buffer, but also to ensure they hold capital commensurate with the relative riskiness of the assets they hold and liabilities they have assumed. Insurers are also required to hold reserves against future losses based on prudent modeling and assumptions.

We strongly support appropriate rules intended to ensure the capital adequacy of insurance entities. For that reason, and as we have stated to the Board in the past,[5] the ACLI believes that any insurer capital framework developed by the Board should be based on the current insurer risk-based capital system ("RBC"). RBC was specifically designed by insurance regulators for insurance entities, and it is a holistic and comprehensive measure of the risks held by those companies. As a result, it is the best suited methodology to measure the capital strength of an insurance company enterprise.

RBC is built on the principles of statutory accounting ("SAP"), where both assets and liabilities are valued conservatively. Statutory accounting takes a long-term oriented asset/liability matching posture that appropriately incents companies to invest for the long term. It intentionally avoids application of fair value accounting rules to most life insurance company assets, thereby avoiding unwarranted volatility in regulatory capital. Such short-term volatility is inappropriate, particularly for life insurers with long-term and inherently stable liability structures.

For these reasons, we believe that the development of a new or additional insurer regulatory capital framework should be based on the existing regulatory structure applicable to insurers under the principles of statutory accounting and the RBC methodology. Doing so will ensure that any new regime appropriately reflects the unique nature of insurance entities and insurance risks versus other financial enterprises, leverages the existing conservative and well-tested regime of insurer financial regulation, and prevents application of potentially overly burdensome and inappropriate requirements to insurance entities.

In response to the ANPR's specific questions:

- The considerations raised in the ANPR are generally appropriate. However, the Board should recognize policyholder protection as a primary consideration of an insurer capital framework, consistent with and as part of financial stability. Any additional methodology developed should complement, not conflict with, that goal. Developing a methodology based on the existing insurance enterprise regulatory scheme applicable to all Board supervised institutions significantly engaged in insurance activities will ensure any potential negative consequence in this regard is avoided.

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would also afford the Board the opportunity to see how the BBA applied to insurance SIFIs compares to other Board-regulated insurers and, concurrently with its field testing and CA refinements, enable the Board to compare those outcomes. Such an approach would provide a sound basis on which to make a determination as to the ultimate approach to be applied to insurance SIFIs.

[5] *See, e.g.*, ACLI Letter to Hon. Ben S. Bernanke (July 28, 2011), *available at* http://www.federalreserve.gov/SECRS/2011/August/20110810/R-1425/R-1425_072811_84755_533039052676_1.pdf; ACLI Letter to Hon. Ben S. Bernanke, Hon. Martin Gruenberg and Hon. John Walsh (July 28, 2011), *available at* https://www.fdic.gov/regulations/laws/federal/2011/11c140ad74.PDF; ACLI Letter to Hon. Ben S. Bernanke (April 25, 2012); *available at* https://www.federalreserve.gov/SECRS/2012/May/20120518/R-1438/R-1438_042512_107212_504336335598_1.pdf.

- Strong consideration must be given to the potential negative consequences that the application of two distinctly different capital frameworks will have on the effected institutions, both in the marketplace and in relations with their current and potential customers. Regulatory changes that impact the pricing of insurance products can have a material impact on insurers and the products they offer. The insurers currently subject to Board oversight compose a small share in many insurance markets. For example, these firms comprised less than 22 percent of variable annuity considerations in 2015.[6] Therefore, the Board should ensure that the capital framework does not create competitive disparities within the industry, reduce the availability of products and services for consumers and businesses, or encourage the migration of certain risk types to firms not subject to Board oversight.

- For reasons discussed throughout this comment letter, the same capital framework should be applied to all insurance institutions supervised by the Board, and that framework should be based on the existing insurance regulatory regime reflected in the insurer RBC methodologies and the principles of statutory accounting. The single framework should be based upon the BBA rather than the CA, and it could include capital stress testing for systemically important insurers. Further, a separate liquidity risk management framework, including robust liquidity stress testing, should apply to insurers designated as systemically important. This approach would satisfy the Board's regulatory objectives and would fulfill the aforementioned principles:

Audited

The Board has stated its preference for the adoption of a capital framework that relies on audited financial statements, but that does not rely upon internal models. The adoption of the BBA would be consistent with this objective. While the CA may begin with audited GAAP statements, it would rely heavily on adjustments to GAAP that are critical to enable comparability in substance across institutions and these adjustments likely would require use of some non-audited financials.

Tailored

The Board notes that it has proposed the CA to better capture all material risks of larger, more complex insurers. Yet the CA, as the Board has acknowledged, would result in relatively crude risk segments and limited risk sensitivity. This is a material weakness of the CA. The BBA is tailored to the business of insurance and to the risks and products prevalent in local markets. The BBA captures risks associated with non-insurance activities and activities with no formal capital regulations, and supports multiple accounting and solvency regimes. Moreover, the use of local regimes, which are constantly evolving in response to markets at the hands of local regulators, ensures the frameworks remain tailored over time. Additionally, the BBA can be augmented with capital and liquidity testing aimed at the risks posed by insurers designated as systemically important if such action is deemed necessary. The CA would require the Board to establish and maintain a highly complex framework for only a few insurers. The Board would also face the challenge of calibrating the appropriate capital requirements for a small universe of companies that would lack any experience operating under the CA framework during different economic cycles.

Comprehensive

A capital framework must capture all material entities and risk types. The CA uses a consolidated balance sheet to capture all entities and businesses, but because the CA applies risk factors to asset and liability segments, it does not explicitly capture individual risk types. In contrast, the BBA uses a bottom-up methodology to include all material

[6] ACLI calculations based on 2015 NAIC Annual Statement data.

entities. The manner in which individual risk types are captured in the BBA is driven by local regulatory regimes.

Consistent

To limit pro-cyclicality in capital requirements, the Board should adopt a capital standard that measures assets and liabilities in a consistent manner. The ANPR did not provide sufficient information on the CA, including the treatment of Accumulated Other Comprehensive Income ("AOCI"), to determine whether it will meet this criterion. The BBA, which relies on local solvency frameworks, would largely mirror the consistent, book-value accounting framework used in U.S. insurer RBC. Entities outside the U.S. may use alternate measures of asset and liability value but, importantly, many such regimes maintain consistency of asset and liability valuation within each operating entity, which is the most critical area for consistency. Exceptions to this are not expected to be a material part of the companies subject to Board oversight.

Comparable

The ANPR cites regulatory arbitrage as a concern regarding the BBA, but this concern does not acknowledge simple adjustments that the Board could make to entity-level measurements or the scalars applicable to foreign regimes to address any arbitrage concerns. Furthermore, the transparency features of a BBA would allow for the ready identification of any intercompany transactions aimed at regulatory arbitrage. The adoption of a bifurcated framework, however, would guarantee inconsistency in capital standards for different institutions and therefore fail to provide a comparable metric to assess insurer solvency across all insurance firms under the Board's purview.

Feasible

Developing the risk segments and appropriate risk factors needed to implement the CA would take several years. This time frame is inconsistent with the Board's goal of developing meaningful capital standards in the short to medium-term. Moreover, as noted previously, maintenance and calibration of a capital framework for so few insurers would be a formidable challenge. In contrast, the BBA is based upon existing regulatory capital regimes, which have been tested and refined over time. As such, it could be easily implemented and maintained.

- The Board has also stated that the CA provides the simplest framework for conducting stress tests. While the CA would provide insight into the solvency of an institution on a consolidated basis, it would not identify capital constraints in individual legal entities. The BBA would accommodate stress testing at the group and entity level. The ANPR also expresses concern about stress testing at the entity level, but this is actually a strength of the BBA, as entity-level stress tests are a more accurate measurement compared to consolidated balance sheet stress testing that can mask substantial weaknesses in a single entity when consolidated with others.

- Based on the aforementioned factors, the Board should adopt the BBA as the single capital framework for the insurance institutions under its purview. To the extent that the Board believes these standards should be augmented to address risks associated with systemically important institutions, the Board can impose capital and liquidity stress testing.

- In contrast to a single framework, the proposed bifurcated framework would complicate insurer risk management practices and would create unnecessary development and maintenance of the capital standard for the Board. Moreover, the competitive disparities among insurers introduced by the use of two frameworks would create an unlevel playing field in any market where the CA is more adverse than the BBA (which aligns with local capital standards). The application of a

single BBA framework to all insurers supervised by the Board would avoid these problems without impairing the Board's supervisory objectives.

- Given the small universe of companies to whom a proposed CA would apply, it is important to weigh all of the resource and other costs that both the Board and the effected regulated entities will confront related to its development, testing and implementation. Since the Board's supervisory objectives for these companies can be readily achieved via application of the BBA, there is no evidence for requiring the resource expenditures associated with pursuit of the CA.[7]

- All supervised institutions should be subject to the same criteria for determining whether the institution is subject to regulatory capital rules that are tailored to the business of insurance. Application of the same criteria is consistent with the application of a single capital framework for insurers. A standard of 25 percent of an organization's total consolidated assets attributable to the underwriting of insurance would be appropriate. Underwriting is the core of the business of insurance, and, as the Board has noted, a 25 percent threshold is used in other similar regulatory contexts.[8]

- In determining whether a supervised institution is significantly engaged in insurance activities, the most important factor to consider is the degree to which the entity's business activities fall under the regulatory oversight of a state or foreign insurance supervisory authority. These activities include but are not limited to: insurance underwriting and risk assumption; insurance policy and contract development, marketing, distribution and issuance; reinsurance; insurance-related investment activities; general policy administration including policyholder payment, claims management and related shared services.

- Any group capital standard that is developed must be based on the existing insurance financial solvency regulatory regime. Doing so will always be preferable to forcing supervised insurers to adapt to an additional regime with precedent setting standards/requirements but lacking historical experience. This should be the case whether an institution is a savings and loan holding company or has been designated as systemically significant, and regardless of its size, business mix or complexity. Multiple frameworks are not needed to capture the risks associated with larger, more complex insurers. A single common framework can be established for all supervised insurers, and that framework can be augmented through capital and liquidity stress testing to address any additional risks posed by systemically important insurers. This is the policy approach that the Board and international banking regulators have applied to the banking industry, and an analogous approach should be applied to the insurance industry.

B. Option 1: Building Block Approach ("BBA")

Summary Response

As discussed above, we believe the Board's proposed Building Blocks Approach is the most appropriate methodology for creating a group capital regime for insurance. The BBA provides a foundation for objective and subjective capital evaluation for Board-supervised institutions that are significantly engaged in insurance activities. The use of existing regimes allows the Board to efficiently and

[7] In addition, before deciding to develop a CA, the Board should seriously consider the possibility that one or more insurers carrying a systemically significant designation today may lose that categorization in the future, and should balance that possibility against the resource expenditures necessary for both the Board and an affected company to develop, test, implement and maintain a second group capital regime in addition to the BBA.

[8] We believe that while in general it would be appropriate to apply the BBA to supervised institutions where 25 percent or more of the organization's total consolidated assets are attributable to the underwriting of insurance, assets alone can be an inadequate measure of insurance activity, especially property and casualty insurance activity. This problem could be addressed by either lowering the threshold or adding an additional trigger using equity supporting insurance activities or a revenue based measure.

effectively achieve its supervisory objectives by leveraging existing capital frameworks that have proven to be robust through time, including during periods of stress. Many of these existing regulatory capital regimes are mature and continue to evolve as markets, products, and consumer needs change.

The concepts put forth in the ANPR with respect to the BBA are well-aligned with industry views on an insurance-appropriate group capital construct for Board-supervised companies, developed by a broad coalition of life and property and casualty insurance companies. Leveraging those views, our response summarizes the key requirements and principles satisfied by the BBA, and responds to questions posed in the ANPR by providing recommendations we believe will enhance or clarify certain design elements of the BBA.

We recognize that the Board has a supervisory objective to enhance financial stability as well as to ensure that savings and loan holding companies significantly engaged in insurance activities ("insurance SLHCs") and SIFIs operate in a safe and sound manner and are able to serve as a source of strength to their subsidiary depository institutions. Meeting this supervisory objective requires that insurance SLHCs and SIFIs maintain a prudent minimum level of capitalization for their unique risk profiles. Achieving this objective efficiently and effectively, without imposing undue burden, requires a capital framework that is tailored to the business of insurance with adequate provisions for material non-regulated activities that could potentially impose capital stress on the insurance group.

We agree with the Board that adjustments are necessary under an aggregation approach which leverages existing capital regimes. As discussed in greater detail below, we have developed a set of proposed adjustments that can be used in the BBA to ensure an appropriate aggregation-based group solvency measure that is transparent and comparable across Board supervised insurers. We also agree with the Board that calibrating and "scaling" or "equating" jurisdictional capital standards in a stable, repeatable manner is necessary for an aggregation-based approach, as each regime has similar but distinct methodologies for determining available capital and evaluating risk in accordance with local supervisory objectives. Thoughtful scalar calibration is necessary to ensure a meaningful group capital framework which avoids mismeasurement or the creation of capital arbitrage opportunities. Our response includes suggestions for the development of scalars, including a process for determining the fit-for-use nature of various regimes, scalar principles and methods, and the appropriate treatment of risk and capital in regimes determined not fit-for-use.

Our responses to questions posed in the ANPR offer recommendations on key considerations that may be useful in designing and implementing the BBA. We hope the recommendations will assist the Board in developing an insurance group capital framework that is consistent with its supervisory objectives in an efficient and effective manner.

Part 1: Key Requirements of the BBA

We believe that the BBA satisfies key requirements of an insurance-appropriate group capital framework. **Table 1** provides our views on these key requirements and how they are met by the BBA. We believe that these requirements also align with the Board's objectives.

Table 1: Key Requirements for an insurance appropriate group capital framework	
Tailored to the business of insurance	• Leverages existing risk sensitive frameworks designed specifically for insurance organizations. • Utilizes proven, well understood, continually evolving standards,
Establishes a near ready-to-implement framework	• Because the BBA is grounded in the use of existing, robust and mature capital regimes, implementation should be reasonably quick with less resource intensity than a newly created alternative standard. New processes will be limited to the identification and quantification of

	certain adjustments and the development of calibration and scaling mechanisms, as described in our response.
Promotes prudent risk management	• Consistent with existing regulatory solvency rules.
Comparable across insurance firms and jurisdictions	• Calibration allows comparison across jurisdictions and institutions. • Maintains comparability across companies within a common jurisdiction, eliminating the potential for distortion of markets by subjecting the companies to different standards. • Allows for comparison of companies within an industry with varying geographic, product, consumer, or other characteristics.
Reflects differences between various insurance, bank, and unregulated activities, including life and non-life	• Reflects differentiated treatment in existing solvency regimes.
Captures risks associated with non-insurance and unregulated activities, including for the holding company	• Considers all entities, and aggregates and calibrates capital measures across existing solvency frameworks
Can work for multiple accounting regimes (SAP, GAAP, other)	• For entities with no formal capital regulation, specifies an appropriate regime.
Subjects the insurance group to an aggregated group solvency ratio	• Provides a group-wide framework that defines and calculates a group-wide capital ratio.

Additionally, the BBA has the benefit of being anchored in existing audited accounting and capital frameworks. The BBA can also be utilized as a foundation for stress testing. The potential weaknesses of the BBA identified in the ANPR can be successfully mitigated through appropriate scaling and carefully considered adjustments, described below.

Part 2: Specific Responses and Recommendations to Implement the BBA

This section provides specific responses and recommendations on the BBA elements, along with supporting rationale for each response and recommendation. This section is comprised of the following subsections:

a) Overall Framework

b) Scope and Applicability of the BBA (including SIFI utilization)

c) Compliance and Effective Date

d) Considerations for Minimum Capital Requirements

e) Determination of the BBA Aggregated Solvency Ratio (including a seven-stage process to complete the BBA calculation)

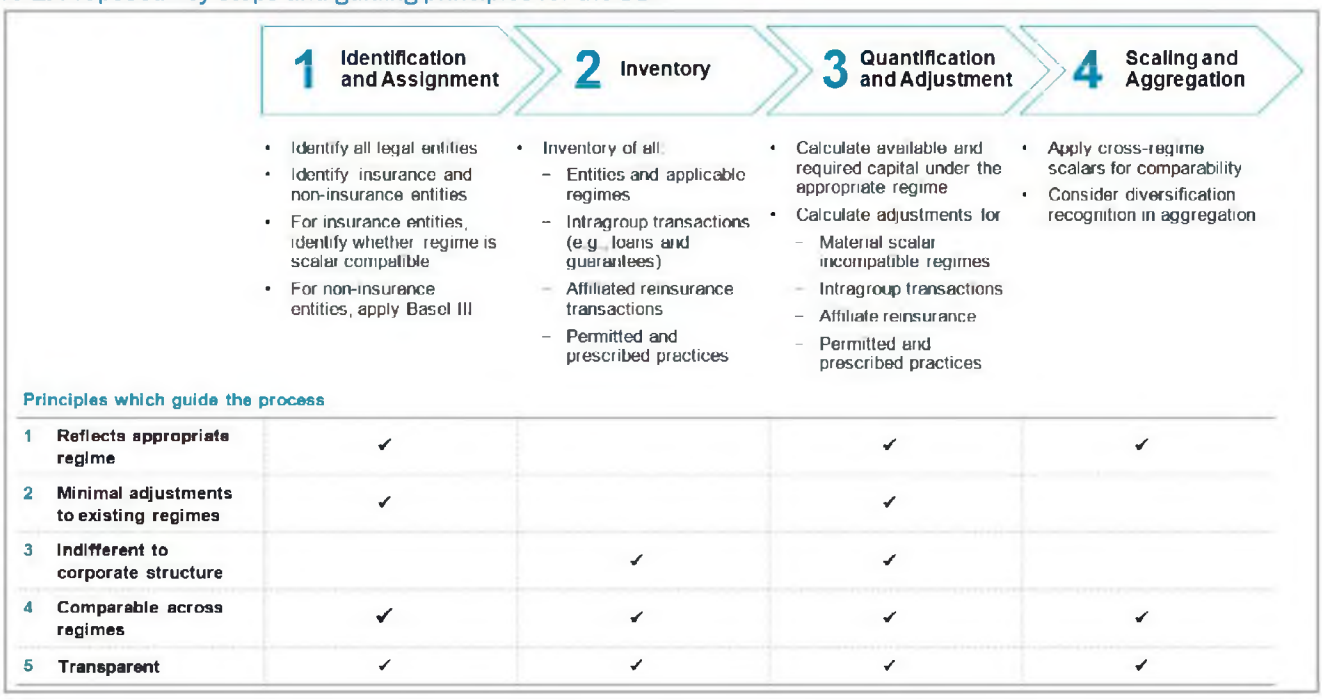
a) **Overall Framework**

We support the BBA's overall approach of aggregating information from local capital regimes. We believe it would be helpful if the BBA framework is guided by a set of over-arching principles to ensure appropriate design, comparability, and consistency. The use of guiding principles also helps ensures consistent definitions and application within the BBA with respect to the corresponding adjustments. We believe these five guiding principles should apply to the BBA:

Table 2: Key Principles to guide the design of a BBA	
Reflects appropriate regime: insurance vs. non-insurance	• All entities differentiated between insurance and non-insurance. • Insurance entities treated under existing solvency regime. • Depository Institutions (DI) treated under existing solvency regime.. • Non-insurance, non-DI entities appropriately treated, if material
Minimal adjustments to existing regimes	• Existing solvency measures preserved where appropriate. • Apply regime at highest level of consolidation where appropriate.
Indifferent to corporate structure	• The location of an entity within the group structure should not impact capitalization at the aggregated level. • Intra-group transactions should not impact capitalization at the aggregated level.
Comparable across regimes	• The group level aggregation must reflect comparable levels of risk, achieved through scaling of capital measures across regimes.
Transparency	• Inventory of all entities, including their regulatory regime. • Inventory of intra-group transactions and related adjustments. • Inventory of specific practices (e.g., permitted and prescribed practices) and treatment within the framework.

By adhering to the guiding principles in determining the appropriate applications of the BBA to supervised firms, the Board can ensure a comparable and consistent group capital framework. In terms of the structure of the BBA framework, we propose four key steps: (1) identification and assignment; (2) inventory; (3) quantification and adjustment; and (4) scaling and aggregation. **Figure 1** describes these key steps and illustrates how they are aligned to the five guiding principles.

Figure 1: Proposed key steps and guiding principles for the BBA



b) Scope and Applicability of the BBA (including SIFI utilization)

This subsection addresses several of the ANPR's specific questions (Questions 11, 12, and 13), including the appropriateness of applying the BBA to large and complex insurance groups. We strongly believe that the BBA, implemented as a principles-based framework with appropriate scaling and adjustments, is able to accommodate institutions with diverse characteristics. The BBA can

appropriately deliver a process for evaluating capitalization regardless of size, ownership interest, corporate structure, breadth of businesses, countries of operation, or other distinguishing attributes through a reasonable aggregation process including appropriate scalars and adjustments.[9] We believe that the BBA is an appropriate framework for all federally-supervised insurance institutions, including SIFIs, regardless of size or complexity.

The BBA can be adapted for SIFIs to reflect the Board's desire for greater supervisory rigor. To satisfy the Board's desire for a supervisory regime for SIFIs that places additional emphasis on capital and liquidity planning and positions,[10] the Board may adapt and complement the BBA with liquidity and stress testing requirements for SIFIs. Additionally, the BBA can be successfully stress tested by transparently testing individual material entities, and aggregating through the BBA framework. This approach allows the Board to develop a view of capital adequacy of the group *and* each legal entity under stressed conditions that align with local solvency standards. In addition, identified SIFIs and most other large insurers already perform statutory stress testing to some extent, and those results could be leveraged for this purpose.

We believe it is appropriate to apply the BBA to supervised institutions where 25 percent or more of the organization's total consolidated assets are attributable to the underwriting of insurance. However, the ANPR indicates it would apply to institutions that "held 25 percent or more of its total consolidated assets *in insurance underwriting subsidiaries*."[11] Because many insurance SLHCs have an insurance company with substantial assets as the top-tier of the organization, this threshold should not be limited to assets held in "subsidiaries." Therefore, consistent with the Board's Regulation Q, the BBA should also apply to a top-tier (parent) savings and loan holding company that is an insurance underwriting company.[12]

c) Compliance and Effective Date

This subsection addresses several of the Board's specific questions in the ANPR (Questions 6 and 7), including the extent to which BBA can leverage existing infrastructure and data, as well as the timeline and challenges in implementing BBA for a supervised institution.

To the greatest extent possible, the BBA should seek to utilize existing records, data, and systems. Regulated insurance and banking organizations have mature capital evaluation and quantification processes in place to meet requirements of existing capital regimes. Leveraging existing audited accounting and capital constructs will speed implementation, minimize complexity and process redundancy, and ensure a fit-for-purpose evaluation of risk.

Because the BBA leverages existing capital constructs, it could be implemented relatively quickly and with less complexity compared to alternative approaches. However, it will take time to develop processes and controls related to *de novo* elements of the calculation. As a result, we recommend the Board allow supervised insurers, at a minimum, 12 months before requiring them to come into compliance with any rules implementing the BBA. In addition, we propose that the reporting frequency of BBA be on an annual basis in order to align with the reporting frequency of RBC and the availability of audited data.

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[9] Responsive to Question 13.
[10] See Governor Daniel Tarullo's speech on May 20, 2016; *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20160520a.htm.
[11] Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 Fed. Reg. 38631, 38632 (June 14, 2016) (emphasis added).
[12] See *also* footnote 7, *supra.*

d) Considerations for Minimum Capital Requirements

The Board has requested feedback on how to set the minimum capital requirements for the BBA. We recommend the BBA anchor to the existing local-intervention level for US insurers (e.g., Company Action Level RBC). This minimum level can evolve over time and be customized as needed, including for application to SIFIs.

In developing minimum capital ratios (i.e., the minimum threshold level), the Board should recognize existing local regulatory minimums and intervention levels as a starting point, especially to the extent that they are used as a scalar calibration points across regimes. Specifically, the RBC trigger points[13] should be used as an initial anchor given the dominance of US insurance assets and risks relative to other jurisdictions for Board-supervised insurers, including SIFIs. The Company Action Level ("CAL") RBC would not need to be scaled if RBC is used as the initial calibration reference point and scalars are developed for other regimes relative to US RBC. The Board can modify this starting point minimum requirement ("CAL RBC") as it gains experience and data through the QIS and implementation.

e) Determination of the BBA Aggregated Solvency Ratio

The BBA is comprised of two major building blocks, aggregation of local solvency measures ("aggregation building block") and the calibration of local solvency measures to the US measure to ensure comparability ("the calibration building block"). We recommend the following process to determine the BBA Aggregated Solvency Ratio.

Within the building blocks of aggregation and calibration we have identified a seven-stage process that builds off the four-step framework discussed earlier in our response that we believe can be used to determine the BBA Aggregated Solvency Ratio:

1. Inventory and Identify: Entities, Classifications, and Existing Regulatory Capital Regimes
2. Identify Affiliated Reinsurance Transactions, Permitted and Prescribed Practices, and Intragroup Holdings and Transactions
3. Incorporate Appropriate Adjustments
4. Scalar Development, Calibration and Application
5. Calculation of Available Capital (Aggregation vs. Uniform, Consolidated Definition)
6. Calculation of Required Capital
7. Calculation of Minimum Aggregated Group Solvency Ratio

We offer a detailed description of this seven-stage process, below in Section IIB, Part 2(e)(1-7):

1. Inventory and Identify: Entities, Classifications, and Existing Regulatory Capital Regimes

Insurance groups are often complex in their organizational legal structure and include diverse legal entity types. Various company structures, accounting constructs, and risk capital regimes can lead to cross-industry distortions of both loss absorption capacity (i.e., available capital), and required capital, which acts as a buffer against unexpected losses. Before calculating an aggregated solvency ratio across all entities, each entity needs to be put on a consistent, comparable basis. This can be accomplished through a series of appropriately structured steps:

[13] The RBC trigger points - Company Action Level and Authorized Control Level RBC – should be used as the initial anchor.

a. *Identify all legal entities*: The insurer can leverage existing regulatory reports, including the NAIC Schedule Y, which identifies the legal entities of the group.

b. *Classify the entity & identify the solvency regime:* For each legal entity identified in paragraph (a), assign a classification based on its legal entity operational purpose, which may include the following: (i) regulated insurance company;[14] (ii) "insurance-related entity;[15] (iii) insured depository institution; and (iv) non-insurance, non-banking institution.[16]

   With a few exceptions noted below, we recommend that an entity be deemed insurance-related if it is either a subsidiary of an insurance company[17] or it is an affiliate of a regulated insurance company that engages in activities for the benefit of, or in support of, the insurance general and separate accounts of its insurance company affiliate, or that are otherwise necessary or properly incidental to the business of the affiliated insurance company.

   However, if the entity is an insured depository institution or commercial lender, an asset manager or registered investment advisor where third-party assets constitute more than 50 percent of its assets under management, or a broker-dealer that derives less than 50 percent of its revenue from the distribution of affiliated insurance products, than it should be deemed a non-insurance entity. Additionally, the Board may choose to determine by regulation that other types of entities, based on their activities, are not insurance-related entities.

c. *Identify the Solvency Regime:* For each entity identified, indicate the existing solvency regime. For regulated entities, the applicable regime used for BBA is the local regulatory regime. For holding companies, the proposed treatment is to apply the same regime that is applicable to its primary entity or entities. For other non-regulated operating entities, an appropriate regime needs to be assigned, based on whether it is defined as an "insurance-related" entity or a "non-insurance" entity. For insurance-related entities, an appropriate insurance regime, that of its most immediate insurance parent, should be used. Such treatment is consistent with the ANPR, although the ANPR is not explicit in prescribing a definition for insurance-related/non-insurance related and its subsequent treatment.

d. *Assign Basel III solvency regime to "non-insurance, non-banking entities:"* For each entity that is classified as "non-insurance, non-banking," assign Basel III as the appropriate solvency regime, subject to the materiality and exclusion tests, defined below.

e. *Determine materiality:* In order to minimize the number of calculations, the BBA should utilize materiality and exclusion tests to determine whether legal entities should be included in the scope of the BBA. In principle, we recommend identifying entities as "immaterial" if they do not have the potential to contribute significant risk to the consolidated organization.

   i. Materiality test: An entity is deemed "immaterial" if (i) it is not a regulated insurance company or insured depository institution; (ii) it contains less than 0.5 percent of the group's total aggregated assets; (iii) it comprises less than 0.5 percent of the group's total revenue; and (iv) the entity presents no demonstrable recourse to the group.

   ii. Exclusion test: An entity may be excluded from the BBA if (i) it is not a regulated insurance company or insured depository institution; (ii) it has less than $100 million in

[14] "Regulated insurance company" means a licensed insurance company or "insurer" as such term is defined under relevant state law or the laws of a foreign jurisdiction.
[15] "Insurance-related entity" means an entity that operates on behalf of or for the benefit of a regulated insurance company.
[16] "Non-insurance, non-banking institution" means all other entities not subject to the classifications in (i) through (iii).
[17] An entity directly or indirectly owned by a regulated insurance company.

total aggregated assets; (iii) it has less than $50 million in revenue; and (iv) the entity presents no demonstrable recourse to the group.

In the case of immaterial entities that meet all three criteria of the materiality test, the Board may wish to consider adopting a simplified approach for these entities, such as the use of the parent's insurance capital ratio even if it's a non-insurance subsidiary. For entities that meet the exclusion test, the Board should allow insurers to exclude these small entities from the BBA calculation if their inclusion poses undue operational burden.

2. *Inventory Affiliated Reinsurance Transactions, Permitted and Prescribed Practices and Intragroup Holdings and Transactions*

Inter-affiliate reinsurance, prescribed or permitted accounting practices, or other nuanced practices may lead to non-comparable bases for both available capital (loss absorption capacity) and required capital (a buffer against unexpected losses) for Board-supervised insurers. As a result, the BBA may need to identify appropriate, governed, repeatable adjustments to restate and compare the risks, required capital and available capital consistently in a fit-for-purpose manner. To do this, we recommend conducting an inventory of affiliated reinsurance transactions, permitted and prescribed practices, intragroup holdings and transactions. Select those items from the inventory that need to be adjusted prior to determining the amount of required and available capital in each entity. The objective of this process is to put all companies on a consistent and comparable basis.

3. *Incorporate Appropriate Adjustments*[18,19]

This section addresses, in greater detail, the Board's request for feedback on what "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." We propose a set of adjustments that align with the Board's requirements.

The key purpose of these recommended adjustments is consistent with the key principles of promoting:

- Comprehensive coverage of risks, while avoiding any double-counting.
- Consistency and comparability of capital across and within regimes to mitigate capital arbitrage.

These principles and requirements align with the Board's stated goals of conforming or standardizing accounting practices under SAP among US jurisdictions, and between SAP and foreign jurisdictions, as well as to eliminate the impact of inter-company transactions.

We recommend a set of specific adjustments as a starting point for BBA. The Board can refine and supplement these adjustments as appropriate over time. The recommended initial list of adjustments and rationales are included in Table 3 below.

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[18] This section is responsive to portions of questions 8, 16.

[19] The Board has requested feedback on what "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." It should be recognized that insurers typically seek variations from traditional state standards either due to unique company circumstances and/or because the existing standards are perceived to create unintended impacts. If existing standards create unintended impacts, the causes may be complex, and solutions may require years of work to develop. Therefore, tools such as permitted and prescribed practices have regulatory value and should not be perceived as efforts by companies to evade requirements or to weaken resiliency. These exceptions are approved by domestic regulators and are reported publicly. Nevertheless, we are cognizant of the fact that the Board places a high priority on consistency and comparability, and we are aware that these variations create a degree of inconsistency among insurers. Therefore, we have identified some areas where the Board may want to give specific consideration.

Table 3: Recommended adjustments for BBA

Topic	Description of issue and rationale for adjustment	Proposed adjustment
Life captive and non-captive business: Term and universal life with secondary guarantees ("ULSG")	The Board may consider adjustments for the use of captives for U.S. term life and ULSG business. The NAIC Principle-Based Reserving ("PBR") standard is expected to replace the current term life/ULSG standards. This standard will grandfather in existing captive treatment and will only apply to new business.	Term life and ULSG business written in the U.S., regardless of captive vs. non-captive status, should follow the same reserving and capital rules. We propose the adoption of the forward-looking PBR standard for reserving and the NAIC Model Law for capital rules (e.g. asset admissibility rules and RBC standard). Consideration may also be given to also applying these rules to grandfathered captives, depending on materiality and complexity.
Variable annuity ("VA") captive and non-captive business	The current U.S. statutory regime for guaranteed variable annuities employs an approach that may not produce a clear distinction between reserves and required capital. • Approach dictates a Total Asset Requirement ("TAR"). • While the statutory framework prescribes a separate set of calculations for reserves, the spirit of the guideline is Total Asset Requirement-based. • Required capital is calculated indirectly as the amount of total required assets in excess of reserves. A lack of stable distinction between reserves and required capital can create volatility in the RBC ratio not aligned with actual risk. As a result, some VA writers employ voluntary reserves.	The Board may consider a simple adjustment to VA reserves and capital by: • Retaining the existing TAR requirement. • Stabilizing the distinction between reserves and required capital by assigning a fixed percentage of TAR which creates comparability across entities (e.g., reserves at 98.5 percent of TAR and capital reflecting the remaining 1.5 percent). See *Figure 5* in the appendix for an illustrative example. Alternatively, the Board may consider adopting the new standards being developed by the NAIC for VA reserves and capital, which are anticipated to be available in 2017. These standards are anticipated to fully address the identified issues.
Other captives and affiliated reinsurance	Insurers may utilize other approved captives and affiliated reinsurance in order to better reflect the underlying risks and economics of their business.	No specific adjustment proposed, given that: • Other uses of captives generally do not result in changes to reserves/capital (e.g., property and casualty risk pools that pool and diversify risks). • Additionally, any such transaction could be reviewed by the Board via the BBA inventory (discussed below).
New York-domiciled insurance entities	New York State ("NYS") reserving standards are generally more stringent than NAIC-prescribed standards, thus reducing comparability.	Available and required capital should be restated based on NAIC Model Law standards. Differences between NYS and NAIC Model Laws are often reported in Footnote 1 of the statutory financial statements.

Topic	Description of issue and rationale for adjustment	Proposed adjustment
		Companies that do not restate financials may opt out of the adjustment.
Intragroup transactions (excluding affiliated reinsurance)	In addition to affiliated reinsurance, there are three major types of intragroup transactions that could distort group capital results: 1. *Investments in affiliates* (including surplus notes) may lead to double-counting of available and required capital (e.g. double leverage). 2. *Intragroup guarantees* may create required capital without economic substance on a consolidated basis. 3. *Intercompany loans* may create redundant required capital (e.g., for guarantees), and may also alter group available capital as a result of deviations in loan asset/liability valuation of the two affiliate entities.	Adjustments to intragroup transactions should eliminate the impact of these transactions on group capital. In line with this objective, we recommend the following adjustments: 1. Exclude the impact of investment in affiliates from available and required capital (i.e., ensuring all capital and risks are comprehensively captured but not double-counted). 2. Eliminate/exclude any risk charge associated with parental guarantees (unless they can be otherwise linked to third parties). 3. Eliminate/exclude any risk charge associated with the affiliate loan, and adjust group available capital for any material differences in loan asset/liability carrying value. See *Figures 7 and 8* in appendix for illustrative examples.
Permitted and prescribed practices	Permitted and prescribed practices may vary by state and entity.	In addition to any permitted and prescribed practices related to items 1-5 above, an inventory of permitted and prescribed practices should be taken but no specific adjustment should be made, unless determined necessary via *ad hoc* review, given that: • The vast majority of permitted and prescribed practices are related to captives and NYS entities that are already adjusted for • The remaining practices generally have valid economic grounding that should be preserved

4. Scalar Development, Calibration and Application[20]

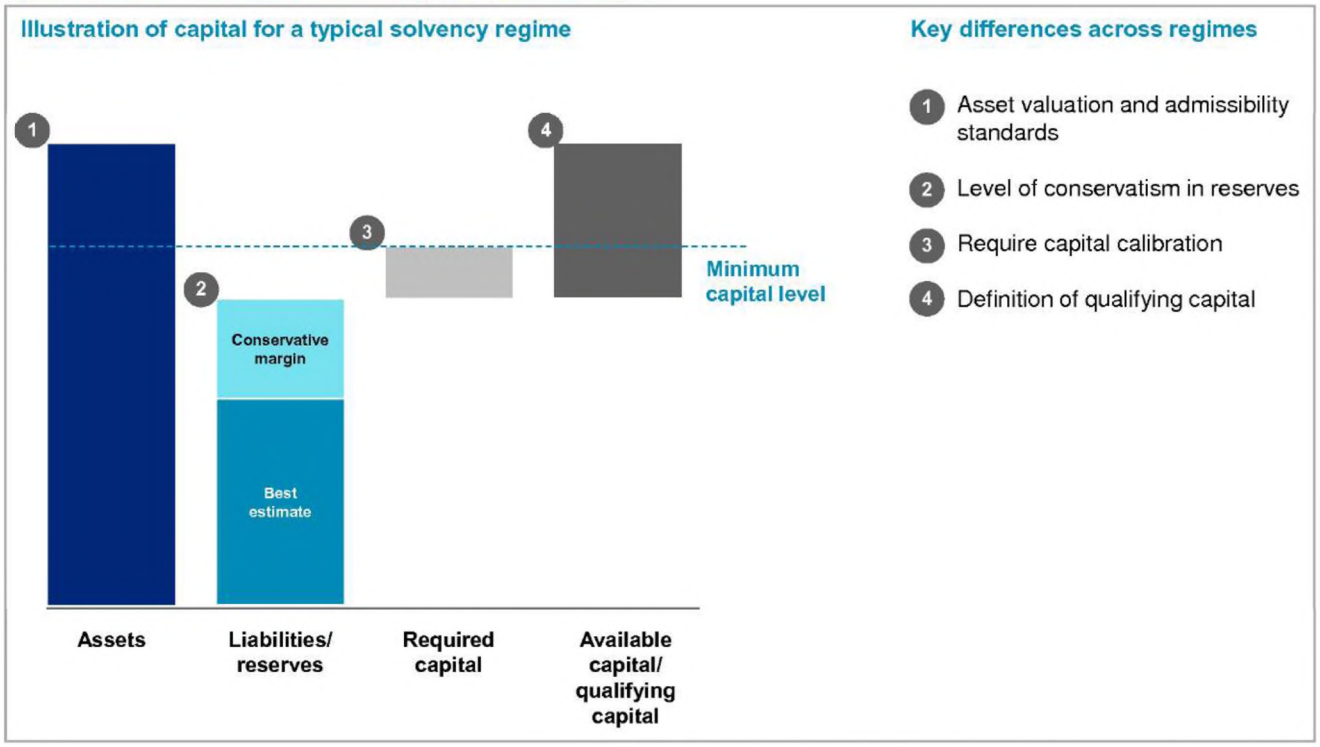
The Board has requested feedback on what "scalars are appropriate to implement the BBA." While we support a scalar-based approach to aggregate balance sheet information across regimes and jurisdictions, we are concerned with the Board's proposed approach of scaling only required capital. To scale only required capital is a simplification, but doing so will not fully capture the difference among regimes in both available and required capital and will result in a lack of coherence between available and required capital levels within a regime, producing a distorted group solvency ratio. It could also create the potential for arbitrage. For these reasons, we recommend that the BBA scale both available and required capital. To address this, and to align with the guiding principle that the group capital

[20] This section is responsive to portions of questions 8, 19, 10.

construct should be "comparable across regimes," we propose a "total balance sheet approach" that applies scalars to both available and required capital.

Scaling both available and required capital enables the BBA to appropriately capture the key drivers of difference across regimes: asset valuation and admissibility standards, conservatism in reserves, calibration of required capital, and the definition of qualifying capital. These elements and their relationship in the context of insurance-company capital are illustrated in **Figure 2**. A comparison of the two approaches, scalars applied to required capital only, and scalars applied to both available and required capital, is included in the appendix.

Figure 2: Illustration of capital for a typical solvency regime:



We recommend calibrating the scalars according to two observable points of each regime: i) the regulatory triggers (e.g., CAL RBC); and ii) the average operating ratio, for insurance groups of similar size and financial health. This approach provides the Board with a simple framework that holistically captures "total balance sheet" differences among regimes and calibrates scalars objectively using robust, observable data. It is important that both calibration points (as opposed to the regulatory trigger or operating level alone) be used to determine the scalar adjustment, because there are differing levels of conservatism in reserves and other differences across regimes that cannot be fully captured in a single calibration point.

The steps in determining an appropriate scalar are:

1. For each regime, identify the capital trigger at which regulators mandate similar actions
    a. Assumes regulators have similar total balance sheet requirements at the regulatory trigger
    b. We recommend the level requiring a corrective action plan (e.g., Company Action Level RBC)

2. Measure average capital ratios for similar companies under each regime; and

a. Assumes like companies hold similar levels of assets relative to their total balance sheet requirement (i.e., liabilities plus required capital)
b. Filter for companies with similar financial strength ratings or other metrics (e.g., total assets, total revenue)

3. Calculate the ratio of excess capital to required capital for each regime (where excess capital is defined as available capital in excess of the regulatory trigger) and compare them to determine the scalars.

Material differences between sectors within a regime, such as life insurance and property and casualty insurance companies, will require separate scalars to adjust for differences in valuation, conservatism standards or required capital calibration. For example, in the U.S., life and property and casualty RBC have similar regulatory intervention levels but distinct operating capital ratios for companies with the same financial strength ratings. A separate calibration of scalars for life and property casualty RBC is appropriate, necessary and can be developed.

In the ANPR proposal, all insurance regimes appear to qualify for use in the BBA. We believe the BBA should distinguish between "scalar compatible" and "non-scalar compatible" regimes because some regimes may not be suitable for scaling if the regimes do not support a robust calibration. To support a robust calibration, the regime must (1) provide a risk-sensitive regime to differentiate between insurers; (2) have meaningful and clear regulatory triggers as the common evaluation basis of insurers' financial health and for comparison across regimes; and (3) be transparent and provide for frequent reporting of capital measures.

To assist in identifying scalar compatible regimes, the Board may leverage existing third-party evaluations of insurance solvency regimes, including: the International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP) determinations; Solvency II equivalence (for solvency) determinations by the European Commission;[21] and the NAIC Qualified Jurisdiction List.[22] Regimes outside of these lists should be considered scalar incompatible.[23]

For entities located in a regime that is considered "non-scalar compatible," we recommend applying a materiality test based on recourse to the group, in order to determine how to calculate the entities available and required capital. If the entity has significant recourse to the group – and is therefore deemed material, that entity should be restated to a scalar compatible regime. Ideally, the restatement regime should minimize the burden of restatement by choosing a restatement regime that leverages the entity's existing accounting standard. If the entity does not have recourse to the group, and is therefore immaterial, then we recommend applying a simple, but conservative risk factor (50 percent) to the entity's carrying value.[24] If restatement proves too burdensome and does not provide a significant benefit, the same 50 percent factor could be applied to entities with recourse to the group, as well.

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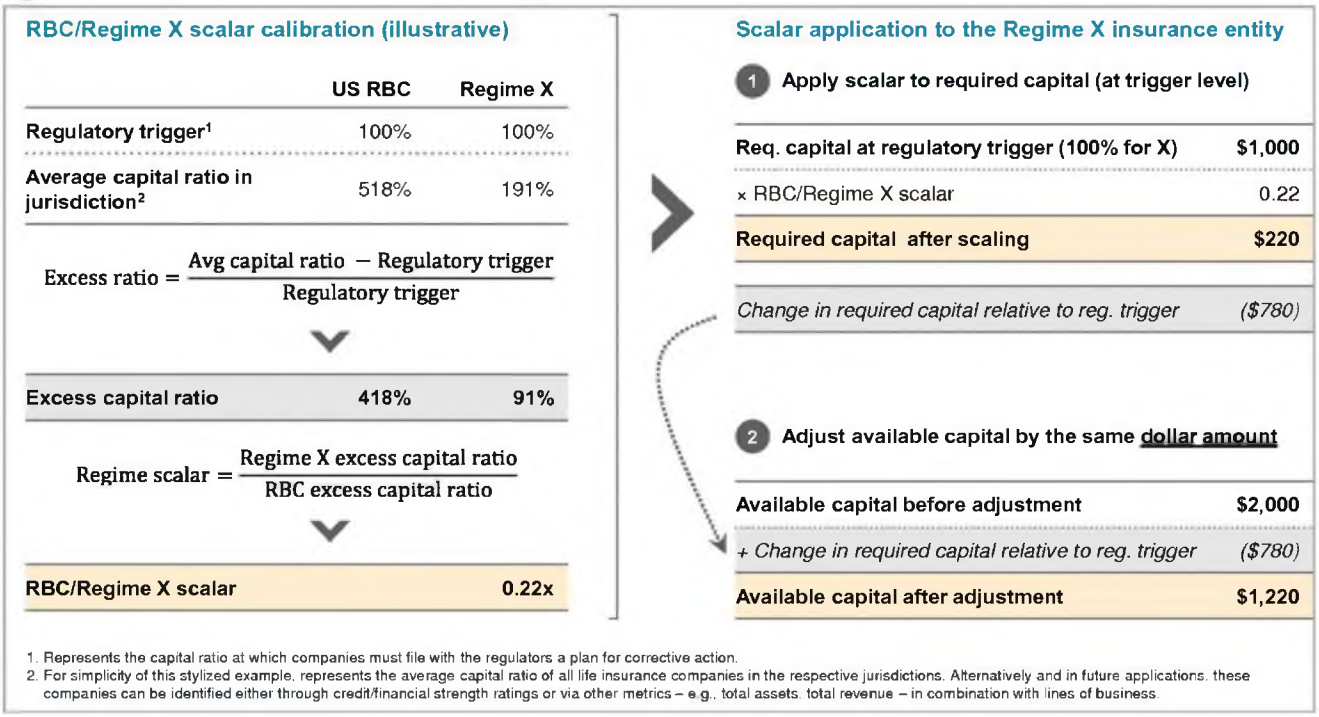
[21] https://eiopa.europa.eu/external-relations/equivalence; http://ec.europa.eu/finance/insurance/solvency/international/index_en.htm

[22] http://www.naic.org/documents/committees_e_reinsurance_qualified_jurisdictions_list.pdf

[23] It is expected that the list of non-scalar compatible regimes will grow shorter over time as global assessment of regimes continues and jurisdictional regimes themselves evolve.

[24] 50 percent is equivalent to the risk charge for an affiliate insurance entity under US property-casualty insurance risk-based capital (RBC).

Figure 3: Illustration of scalar calibration and application of scalar



Also see Figure 9 in Appendix.

Prior to any implementation, we strongly recommend further study via field testing or other means, to determine which regimes would require scalars and the extent to which non-scalar compatible regimes are material.

In addition, to the extent the Board pursues a simplified methodology of scaling only required capital and does not scale available capital, we strongly believe further study needs to be completed to fully understand the implications of this simplified approach. It also will be important for the Board to consider how scalars are actively managed in the future to stay current with underlying regimes and operating rangers. However, if there are scalar updates, it is paramount to give impacted entities sufficient notice to ensure there is time to adapt and adjust models without causing unexpected regulatory capital metric volatility.

5. *Calculation of Available Capital (Aggregation vs. Uniform, Consolidated Definition)*

This section addresses the Board's request for feedback on how to determine the available capital of the insurance group and whether a uniform definition of qualifying capital should be adopted. A suggested method is to aggregate available capital at each legal entity, adjusting for other factors such as qualifying capital in the calibration and application of cross-regime scalars. This simple approach recognizes the interdependency in each solvency framework of the asset and liability valuation, required capital and capital eligibility, as well as the inability to require many industry participants to produce a consolidated balance sheet.

The ANPR discusses two potential approaches to measure available capital:

1) Apply a common definition of available capital on a fully consolidated basis and

2) Sum available capital for each legal entity, according to the local regime.

We believe that the first approach, applying a common definition of available capital on a fully consolidated basis, is not practical or necessary for the BBA. While a uniform definition of qualifying capital could simplify the process for determining available capital resources by eliminating some of the adjustments and addressing the potential for double leverage, a uniform definition also has serious deficiencies. A uniform approach cannot appropriately account for differing levels of asset valuation or liability conservatism in different underlying accounting regimes. Nor is it clear how a uniform, consolidated definition of capital could be utilized without a consolidated balance sheet.

The ACLI believes that the second approach, the summation of available capital, is the appropriate approach for the BBA. This approach, along with the application of adjustments and scalars, will ensure alignment with the required capital component of the BBA and a coherent group solvency ratio.

The ANPR also discusses the possibility of tiering capital. We do not believe that the Board should categorize qualifying capital into tiers given the desire for and benefits of minimizing adjustments to existing capital standards and audited financials. Additionally, we believe it is best to avoid introducing additional complexity at this early stage of development and implementation of the BBA.

6. Calculation of Required Capital

This subsection addresses the Board's request for feedback on how to aggregate required capital of the insurance group, and how to set the baseline capital requirements for each local regulatory regime. In addition to scaling available capital, our suggested method is to adjust, scale and aggregate required capital of each legal entity as needed to ensure an "apples-to-apples" aggregation. While our proposed approach is generally consistent with that described in the ANPR, we have proposed several specific recommendations on the application of the scalars, the identification and treatment of scalar-compatible and non-scalar compatible regimes, and the treatment of holding companies.

After the adjustments and scaling steps are performed the required capital identified within a consolidated group of entities is additive and represents an appropriate level of capital for measurement at the group level.

It is worth noting that companies with a wider geographic footprint, as well as companies that have material operations across different financial sectors, have risk diversification (uncorrelated underlying risks) which are not accounted for in the proposal put forth by the Board. The aggregation of total required capital under the BBA framework should recognize diversification benefits across geographies and business segments.

Table 4: Recognition of Diversification

ANPR proposal	ACLI recommendation / proposed changes	Rationale
Diversification benefit should be recognized across geographies and business segments	The BBA should capture diversification of risks across legal entities of the group. The industry recommends consideration of the following risk factors for diversification: • Geography (e.g. across continents) • Risk type/business segment (e.g. across life insurance vs. property and casualty insurance vs. banking vs. other non-insurance) These factors can be implemented via a formulaic approach that is based on the pairwise correlations of risk components.	An effective risk aggregation approach should recognize risk diversification that aligns with underlying economic risks, improving the solvency signal, and promotes prudent management (e.g., to pool less correlated risks). There are risk diversification factors across legal entities that are not yet accounted for, most prominently:

ANPR proposal	ACLI recommendation / proposed changes	Rationale
	The industry recommends inclusion of only risk diversification *across* entities, given that intra-entity diversification is already considered via existing entity-based regimes.	• Insurance-related stresses (e.g., catastrophe, mortality) vs. financial risks • Catastrophe risks across major geographical divides

7. Calculation of Minimum Aggregated Group Solvency Ratio

The baseline capital requirement should be set to the regulatory intervention level for the relevant regulatory regime (e.g., Basel III or U.S. RBC).[25] For U.S. insurance companies under RBC, the baseline capital requirement is the level at which U.S. insurance companies must file a corrective action plan. For U.S. life insurance entities this is defined as 100 percent of NAIC Company Action Level Risk Based Capital ("CAL RBC"). The use of existing "scalar compatible" capital regimes along with appropriate scalars, adjustments, calibration techniques and aggregation will result in a consolidated ratio that can be measured against this baseline.

$$BBA\ capital\ ratio = \frac{Sum\ of\ Qualifying\ Capital\ Resources^{26}}{Sum\ of\ (Required\ Capital\ x\ Scalars)} > 100\%\ GSR$$

Part 3. Strengths and weaknesses of the BBA

This subsection recaps and discusses the strengths and weaknesses of BBA as discussed in the ANPR. We believe that most of the weaknesses indicated in the ANPR can be addressed by simple adjustments and scalars. In particular, we believe that the BBA's ability to stress-test at the legal entity level is a strength, not a weakness. We recognize that the development of the scalars and other adjustments will require a reasonable time to implement, but believe this timeframe to be significantly less than would be required by the CA.

The ANPR notes a number of strengths and weaknesses of the BBA. These are recapped in Table 5 below, with corresponding comments from ACLI.

Table 5: ANPR strengths and weaknesses

Strengths specified in ANPR	ACLI comment
1. Leverages local regulatory capital	We agree with the Board that these are important strengths of the BBA. That said, while the BBA can be implemented more expeditiously than alternatives developed to date, there are still significant components that will require Board development, such as the development of scalars, and areas requiring insurer build-out, such as captive adjustments.
2. Can be implemented expeditiously	
3. Results in low regulatory cost and burden	
4. Tailored to risks of jurisdiction and line of business	

[25] Responsive to Question 14.

[26] See Sec. II B, Part 2(e)(5), *infra,* for a discussion of qualifying capital.

Weaknesses specified in ANPR	ACLI comment
A. Results in aggregated, not consolidated, capital	While it is true the capital results are aggregated and not consolidated, the capital results would be adjusted and scaled as appropriate to enable comparability across regimes and essentially provide a proxy for consolidation; in addition, a legal entity view provides additional transparency to the Board.
B. Prone to regulatory arbitrage and gaming	Similar to A above, capital results would be adjusted and scaled to minimize regulatory arbitrage.
C. Necessitates extensive adjustments to account for inter-company transactions	The number of adjustments for intragroup transactions is relatively small and easily manageable even for the largest insurance groups, including SIFIs. That being said, we recognize there is a need for several other adjustments beyond intragroup transactions as well.
D. Requires development of large number of scalars	Calibration should follow a systematic methodology, that can be applied to any regime. A greater number of regimes requiring scaling does not pose significant increase in difficulty, because the scaling will follow a common methodology for all regimes. In addition, the number of scalars would be limited to relevant scalar compatible regimes, which is estimated to be less than 15 regimes, even when SIFIs are included.
E. Requires legal entity level stress tests	On the contrary, the ACLI believes that the ability to perform statutory stress tests at the legal entity level is a strength, not a weakness, of the BBA. Although it presents operational challenges, it also provides transparency into the legal entities during times of stress.

One additional complication of BBA is the difficulty of developing robust scalars. For example:

- Many factors have to be accounted for in a single scalar (e.g., assets, liabilities, required capital, and available capital).
- Point-in-time vs. through-the-cycle considerations as scalars may change through the credit cycle. For example, different regimes react differently in stressed versus normal conditions.
- Calibration using empirical data needs to consider the impact of BBA adjustments.

However, it is also worth reiterating that the vast majority of Board-supervised assets and risks are US-based, and that the scalar calibration can be improved and refined over time, in the same way that BBA adjustments and other aspects of the BBA can evolve as needed over time. In general, we believe that the perceived weaknesses of an aggregation approach are avoided through appropriate, coherent adjustments and scaling, guided by over-arching principles that enable application to any type of insurance group and full transparency to regulators.

We believe there is strong and ample evidence that a BBA insurer group capital standard, modeled on the framework we have outlined above, can and should be the insurer group capital approach developed by the Board and made applicable to all insurance entities under its regulatory purview. We strongly urge the Board to give thoughtful and serious consideration to doing so in lieu of deploying time and resources to develop a second insurer group capital oversight regulatory regime.

C. Option 2: Consolidated Approach ("CA"): Design Considerations for the CA

As explained above, ACLI believes that the BBA, rather than the CA, is the better capital framework to apply to all Board-supervised insurers and would better meet the Board's stated supervisory objectives.

The CA proposed in the ANPR is presented at a very conceptual level and lacks many details that will be important to understand before fully assessing the feasibility of the CA, which underscores how complicated design of the full framework may be. Nonetheless, a CA based on GAAP accounting,[27] with appropriate adjustments, could, potentially, be a feasible approach to a group capital standard for insurers. ACLI provides below certain key considerations it believes will be essential in the design of a CA appropriately tailored to the business and risks of insurance groups should the Board determine to continue to pursue its development.

Key overarching considerations

Any CA that is developed must properly take into account certain key principles, including the long-term nature of insurance liabilities, prudent risk mitigation measures built into insurance contract features and typically deployed in the management and regulation of insurance companies, and the inapplicability for insurance holding companies of the "source of strength" model that applies to bank holding companies. The CA must also apply appropriate definitions of available capital, reflecting loss absorption capacity, and of required capital, reflecting the risk borne by insurance companies and the way these risks manifest themselves.

The Board states that it will use risk weights and factors that are appropriate for the longer-term nature of *most* insurance liabilities. There are generally no truly "short-term" insurance liabilities although property and casualty liabilities are often less long-term than life insurance liabilities, neither is generally correlated with market and other economic risks, and neither exhibits the short-term nature of bank deposit or similar liabilities. Some life insurance and annuity products do possess features that correlate with market risk, but the nature of these products (including the purpose for which most customers purchase them) and several existing risk mitigants substantially eliminate the risk of such products being short-term liabilities. Historically, due to economic, contractual and regulatory reasons, life and annuity products that permit early surrender or withdrawal are not subject to significant "run" risk and behave more like long-term liabilities. It is essential that the Board recognize and include the policyholder behavioral drivers of low surrender risk such as motivation for obtaining and maintaining insurance protection, as well as contractual limits on withdrawals, penalties for early withdrawals, possible difficulties in obtaining comparable coverage, and surrender deferral periods into the applicable risk weights and factors to be applied to such products (and to factor such features into any stress tests it applies).

Insurers have intentionally introduced contractual risk mitigants into their insurance products precisely in order to protect against surrender and liquidity risk. Risk mitigants designed to protect the solvency and liquidity of insurers should not be turned into risk enhancers by forcing insurers to hold more capital on the false assumption that insurers would not avail themselves of contractual provisions that they bargained for.

As a general matter, prudent risk mitigation needs to be recognized in any final CA. This includes, in addition to the contractual risk mitigants mentioned above, asset-liability management, diversification among risks, hedging practices, reinsurance, and risk-sharing with policyholders. Disregarding risk mitigation would perversely lead to an Insurer SIFI having to hold additional capital that is not required of other insurers with similar products and facing similar risks and exposures.

Appropriately tailoring any group capital framework to the business of insurance also requires acknowledging, and adapting the framework to, the unique way in which insurance companies are structured and regulated, including existing regulatory limits on the fungibility of capital. In particular, the "source of strength" model that applies to bank holding companies is simply not a model to be applied to insurance holding companies, which generally have very limited operations and are not

[27] A CA could also be developed that utilizes Statutory Accounting Principles (SAP) as its basis and is comparable to a GAAP-based CA.

required to serve as a source of liquidity for their insurance subsidiaries (absent contrary contractual arrangements or regulatory undertakings). Rather, insurance holding companies often rely on cash distributions from their operating subsidiaries to meet their limited cash flow and liquidity needs. Thus, requiring insurance holding companies to be a "source of strength" for their insurance subsidiaries would represent a fundamental departure from historical and existing insurance company regulation. We believe the BBA would better align with regulatory limitations on insurance capital fungibility. We are concerned that the CA could, in this respect, result in a bank-centric approach that would not be appropriate for Insurer SIFIs. In any event, the fungibility of capital and the location of capital among affiliates must be appropriately reflected in any CA developed for Insurer SIFIs.

Finally, it is important to ensure that the CA should not include or effectively result in a SIFI surcharge. Any perceived systemic risk can and should be addressed through capital and liquidity stress testing.

Key considerations as to Qualifying Capital in a CA

Because GAAP equity does not provide an accurate measure of an insurer's loss absorption capacity, adjustments will be needed in order to produce a meaningful and appropriate measure of Qualifying Capital. Two key adjustments relate to the inclusion in Qualifying Capital of margins in reserves and the removal from Qualifying Capital of the unrealized gains/losses recorded in GAAP 'Accumulated Other Comprehensive Income' ("AOCI").

Margins in reserves

Qualifying Capital should reflect the insurer's full loss absorption capacity. This is primarily achieved with the adjustment of GAAP insurance liabilities to best estimate levels,[28] allowing for the loss absorbing margins in reserves to be recognized in Qualifying Capital.[29] Unlike banks, whose liabilities represent "best estimates" of deterministic liabilities, the net GAAP liabilities for insurance contracts generally include an element of conservatism over and above the best estimate of the liabilities. This margin above the best estimate stems from required conservatism in some of the valuation assumptions and other GAAP requirements which essentially increase the liability to defer the recognition of day 1 profits over the lifetime of the insurance contracts. An insurance company's net GAAP liabilities are supported by invested assets. The net GAAP liability and the supporting assets exceed the expected amount needed to fulfill the insurance obligations, but that excess is not recognized in GAAP equity. These margins (and the assets supporting them) are available to cushion against shocks to Qualifying Capital and should be included as Qualifying Capital (and as Qualifying Capital of the highest tier, if tiering is applicable). As the purpose of these margins is precisely to provide additional resources to absorb losses that might exceed "best estimates," they should clearly constitute Qualifying Capital.

AOCI Adjustment

The measurement of Qualifying Capital should recognize the asset-liability management ("ALM") that underpins the insurance business model. Insurers invest in high quality assets and hold them to maturity to support generally long-term insurance liabilities. Insurers hold a much

[28] Best estimate liabilities ("BEL") are defined within GAAP's Loss Recognition Testing ("LRT") rules. BEL is based on the insurer's best estimate assumptions and discount rates that reflect the assets supporting liabilities (i.e., asset earned rate and future reinvestment yields, adjusted for expected defaults and investment expenses). Other liabilities not subject to LRT can nonetheless be restated to best estimates using straightforward GAAP-anchored adjustments.

[29] A life insurance company's reserves consist of two components that are established at the inception of the contract: (1) "best estimate" of the present value of future benefit payments, net of current and future premiums and all expenses; and (2) a "margin" which covers unexpected losses. Depending on the type of product and accounting rules, the margin may be driven by multiple items, such as conservatism in assumptions, risk margins, and/or deferred profits. Insurance company reserves (both the best estimate and margins) are backed by invested assets on the balance sheet.

greater proportion of long-dated available-for-sale ("AFS") securities than banks; this is an important part of insurers' ALM risk management. Market value changes should only be relevant to the extent that an asset is bought or sold. An asymmetric treatment of assets and liabilities in the valuation of Qualifying Capital would likely lead to artificial volatility and pro-cyclicality. By excluding from Qualifying Capital the unrealized gains/losses recorded in GAAP AOCI, symmetry between assets and liabilities can be achieved, thereby eliminating artificial volatility and pro-cyclicality. Not removing AOCI in the calculation of Qualifying Capital would likely lead to a misleading representation of an insurance group's capital position, as capital adequacy at any time may be artificially overstated or understated depending simply on the movement of interest rates and credit spreads.[30] Any concerns with potential risks of ALM mismatch would be better and more efficiently addressed through stress testing or liquidity measures as opposed to attempting to handle such risks through a blunt factor-based approach.

Other Potential Sources of Qualifying Capital

Other loss absorbing capital should be recognized in Qualifying Capital under the CA, including:

- Certain capital market instruments, depending on their structure and loss absorbing characteristics, including: perpetual preferred stock (whether or not dividends are cumulative), surplus notes, junior subordinated notes, and contingent convertible securities;

- Deferred tax assets ("DTAs") because they have value on a going concern basis and retain some value in winding up;

- Other such capital loss absorbing resources; and

- Senior debt issued by the holding company that is then down-streamed as equity into an insurance subsidiary. Such debt would be structurally subordinated to policyholders since, as a matter of law, holders of senior debt at the holding company stand behind liabilities at the insurance company subsidiary. In many cases funds down-streamed cannot be transferred back up without complying with applicable regulatory tests and/or gaining regulatory approvals. Such funds could absorb losses on a going concern and winding up basis.

Tiering of Qualifying Capital

The ANPR explores the idea of tiering capital resources. We believe that establishing tiers of Qualifying Capital is unnecessary as it conflates capital and liquidity by imposing restrictions and requirements around capital resources that are aimed at ensuring appropriate liquidity when needed. Given the nature of Required Capital for insurers, which relates to both short term "event" risks and long term "slow bleed" risks, such restrictions on Qualifying Capital would be unnecessary and inappropriate. Instead, we believe that all tangible loss absorbing resources should be counted as Qualifying Capital for the CA or any group wide insurance capital framework, and that an appropriately tailored liquidity risk management framework for Insurer SIFIs should distinguish those assets required to meet liquidity demands based on appropriate criteria. To the extent that tiering is applied, it should be focused on differentiating based on quality of capital resources and on recognizing additional loss absorption capacity through the use of a second tier of capital. Tangible loss absorption capacity, including margins in insurance

[30] It should be noted that the International Association of Insurance Supervisors ("IAIS") is exploring what it calls a "GAAP with Adjustments" valuation approach in which an AOCI adjustment would be applied to address asymmetry in the valuation of assets and liabilities. The AOCI adjustment would be applied to capital resources such that assets and liabilities would both be measured on a more consistent basis, thus reducing unintended volatility in capital.

reserves, should be reflected in tier 1 capital. Additional loss absorption capacity, such as senior debt issued by a non-insurance holding company and contractually or structurally subordinated to policyholder claims should be reflected as additional capital through tier 2.

While the preceding discussion focused on the key considerations in constructing a CA based on GAAP accounting as proposed in the ANPR, a comparable CA could also be developed with Statutory Accounting Principles (SAP) as its basis. We note that including a SAP-based CA in addition to a GAAP-based CA would increase the expected time and effort required for development, testing and maintenance.

Key considerations as to Required Capital in the CA

Required Capital in the CA should be based on factors applied to specific drivers and appropriately aligned to the risks borne by the insurer. It is recommended that risk factors be based on RBC rules since those have been developed and refined over many years. Formulating new and potentially inconsistent insurance risk factors could lead to lack of comparability, mismeasurement of risk, and capital inefficiencies (since risks borne by insurance companies are already subject to capital being held at the insurance company level). This approach has the appeal of being readily implementable, easily maintained, and comparable with the BBA. The construction by the Board, which has not historically supervised insurance companies, of entirely new risk charges and standards is, ACLI believes, unnecessary and could lead to unintended consequences. To the extent that the Board wishes to develop new factors, however, it is important to recognize the following:

- *The exposure bases to which risk factors apply must be appropriately aligned to the drivers of a particular risk.* For instance, the face amount of life insurance in-force is an appropriate basis for mortality risk exposure as it is aligned to the way the risk will manifest itself for a life insurance company (i.e., through death benefit payments).

- *Insurers should not be subject to capital charges for risks which are passed on to policyholders.* Separate account assets for which the insurer does not bear any asset risk should not be subject to risk charges. (General account guarantees of separate account assets would be captured through appropriate risk charges applied to general account assets). Policyholders bear the risk associated with separate account assets and they have no direct call on an insurer's capital. From a GAAP accounting standpoint, there is a separate account liability on the balance sheet that is necessarily equal in amount to the separate account assets, so the insurance company is fully insulated from any fluctuations in the value of these assets. Separate account assets–whether guaranteed or not--should get zero risk weighting (assets backing guarantees would be treated in line with other general account assets). Participating insurance policies, which pass risks on to policyholders through the participation mechanism, should be subject to risk charges commensurate with the actual, reduced risk they pose to the insurance company. In some cases, the residual risk of such policies is so remote as to result in no risk charge at a given calibration level, for example, such as a 97.5th or 99.5th percentile threshold. Assets and liabilities associated with fully participating policies (and those associated with a closed block) generally pose minimal or no solvency risks for insurers, as the underlying risks associated with these policies are in large measure borne by policyholders or are otherwise subject to significant cushions and protections. Any timing differences between the occurrence of an adverse event and the pass-through of that experience to policyholders (e.g., through adjusting participating dividends) would be a temporary liquidity concern only and should be addressed through liquidity risk management measures. It should not translate into additional capital requirements.

- *The required capital framework must appropriately tailor asset/credit risk charges for insurance.* Policy loans should also receive zero risk weighting. Policy loans are essentially contra-liabilities and reflected as assets on an insurer's balance sheet since they reduce dollar-for-dollar the cash value and death benefit of the subject policies--no counterparty or credit risk is involved (as with participating policies, any potential timing issues in respect of policy loans should be handled through liquidity risk management measures). Corporate bonds held by insurers should be risk-weighted appropriately. Insurers, unlike banks in many respects, typically invest in highly-rated investment grade bonds that are held to back long-term liabilities. Because bonds held by insurance companies are generally limited to backing long-term liabilities, risk factors for high-grade bonds should be based on probability of default/loss given default.

- *The required capital framework must appropriately reflect fundamental aspects of insurance risk and risk diversification.* Insurance risks must, of course, be appropriately reflected in any insurance group capital standard. The amount of risk capital required to withstand insurance shocks (e.g., mortality, longevity, lapse, morbidity/disability, natural catastrophes, etc.) should reflect the benefit of diversification among insurance risks and other risks. The CA should be appropriately calibrated to reflect the probability of concurrent insurance and market risks and other economic stresses. Required Capital should reflect modest factor calibrations so as not to overstate risk at a global level, considering the diverse nature of risks insurance groups are subject to. To the extent that risk diversification is not taken into account explicitly, the CA factor calibrations must do so implicitly. Calibration of Required Capital may need to be modest given the initially simple, factor-based design of the CA, and must take into account the risk mitigation inherent in the diversity of risk exposures within an insurance group and across the industry. In addition, modest calibration is appropriate to avoid arbitrage and competitive distortions across firms' subject to different regimes. Given the simple and blunt nature of a factor-based capital requirement, risk sensitivity is best evaluated through appropriately designed capital and liquidity stress testing.

D. Other Assessed Frameworks

The ACLI strongly supports the Board's determination that a market-adjusted valuation approach as in the IAIS' current Basic Capital Requirement ("BCR") framework is inappropriate to apply to either systemically important insurance companies or insurer-affiliated savings and loan holding companies based in the United States. While a market-adjusted approach may be appropriate for some countries, the valuation framework may be difficult to reconcile with U.S. GAAP and, based on the current BCR design, would likely introduce excessive non-economic volatility that would discourage long-term investing and the offering of prudently designed and managed long-duration insurance products. A market-adjusted approach could limit the availability of insurance products that U.S. consumers depend on for long-term financial protection and retirement security. In addition, such a market-adjusted valuation approach would be highly pro-cyclical, and such a pro-cyclical regulatory regime could decrease the ability of life insurers to act as a market-stabilizer in times of financial stress or crisis.

The ANPR reports that the Board plans to continue exploration of internal stress testing "as it builds its supervisory stress testing for systemically important insurance companies and its broader supervision program for supervised institutions significantly engaged in insurance activities."[31] Although the ANPR says that the CA "would more easily enable supervisory stress testing," we believe that the BBA can be successfully stress-tested in a transparent manner using Board-designed macroeconomic scenarios and a post-tax deduction linked to insurance risk regulatory capital ("the Insurance Deduction Approach"). This approach, which could be implemented in the short-to-medium term, would provide the Board with

[31] Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 Fed. Reg. 38631, 38637 (June 14, 2016).

an objective and comparable source of the insurance stress measures, while also providing a macro and micro-prudential view.

The Insurance Deduction Approach would stress capital market assumptions using Board defined scenarios and then deduct a required amount of capital for insurance risks from available capital. The insurance risks in this approach are standardized risks anchored to regulatory regime risk charges, an approach that is analogous to the insurance subsidiary deduction in U.S. Basel III and also incorporates diversification across risks. The insurance stresses are applied at the "worst" point (e.g., the lowest Group Solvency Ratio) of the adverse macroeconomic scenario. Our analysis of this approach shows that it provides the appropriate level of overall scenario severity. The Insurance Deduction Approach does not rely on internal models and largely aligns with the Board's Capital Adequacy Process ("CAP") principles. We hope that the Board will seriously consider this approach for stress testing.

The ANPR also expressed concern that internal stress testing relies on internal models that can lack transparency to supervisors and market-participants. While we believe that the Insurance Deduction Approach, which does not rely on internal models, is the most desirable stress testing methodology, if the Board does opt to adopt a form of internal stress testing, we believe it can be done in a way that preserves transparency. For example, the Board could set parameters for internal stress testing and companies could submit their models to the Board for review. Combining an internal stress testing approach with a standardized capital requirement would also reduce the degree of reliance on internal models for a baseline capital requirement.

III. *Appropriate Supervisory Approach*

As it develops its insurer capital framework, it is essential that the Board also consider establishing an appropriate supervisory approach for the framework's implementation, application and enforcement. The significant differences between insurers' business models and those of other financial sectors are not limited to their balance sheets; they also are evident in different internal structures, daily activities and decision-making systems. In applying and overseeing the capital rules developed as a result of this ANPR, the Board must be cognizant of those differences and move forward accordingly.

Once developed, we expect that the implementation, application and enforcement of this insurer capital framework will likely take place via the Board's prudential regulation and oversight structure. In that regard, the ACLI has submitted commentary on the Board's notice of proposed rulemaking on enhanced prudential standards.[32] The issues of concern we raise in that commentary are also applicable to eventual implementation, application and enforcement of any insurer capital framework adopted by the Board; we ask that you consider those issues incorporated by reference.

In closing, we thank the Board for its thoughtful consideration of our views. We are available for further discussion on this matter at your convenience.

Respectfully submitted,

Julie A. Spiezio

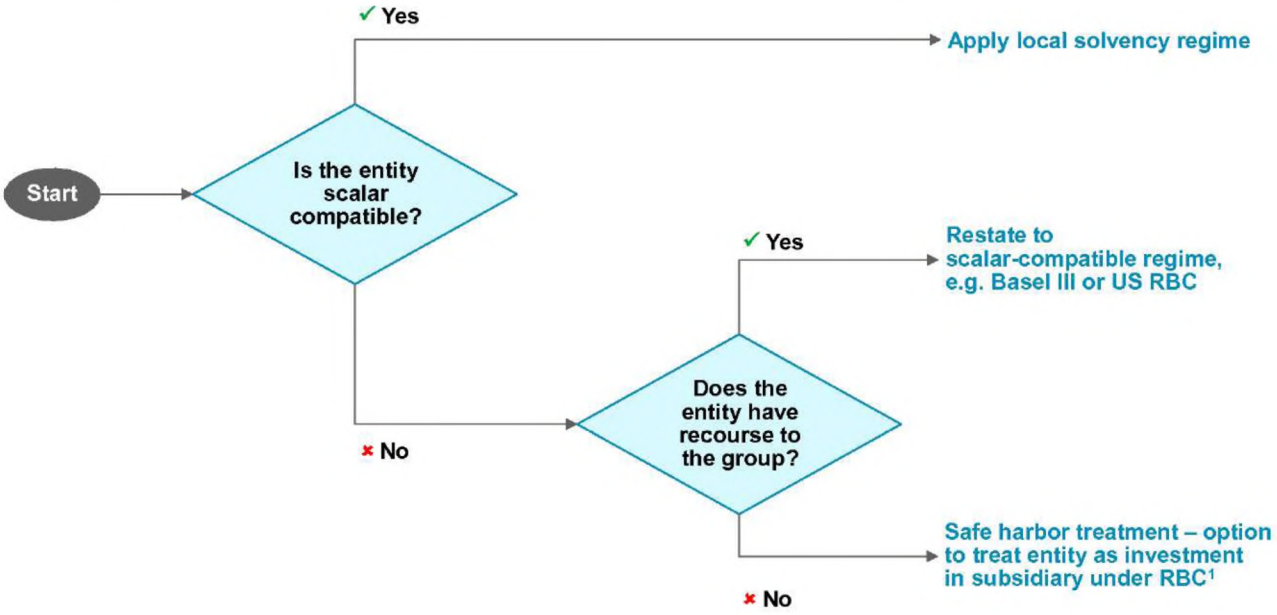
Mariana Gomez-Vock

CC: Thomas Sullivan
Linda Duzick

[32] See ACLI Letter to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System (August 17, 2016).

Appendix 1: Supplemental illustrations of industry recommendations to BBA

Figure 4: Capital treatment for scalar compatible and non-scalar compatible regimes:



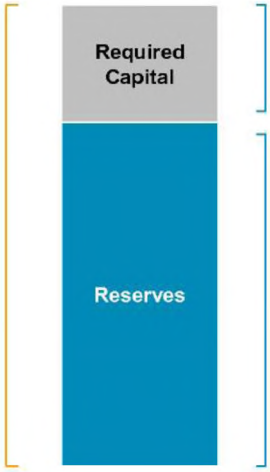
1. Treat GAAP equity (ex. intangibles) as available capital and apply a 50% risk charge for affiliate insurance entity (more conservative risk charge under US RBC)

Figure 5: Illustration of adjustments for VAs [Adjustment 2]:

Total Asset Requirement

Calculation is unchanged from the current statutory framework

- Maintains the spirit of the current statutory framework – i.e., minimum total funding requirement
- Includes cash surrender value and reserves/capital for guarantees



Required capital

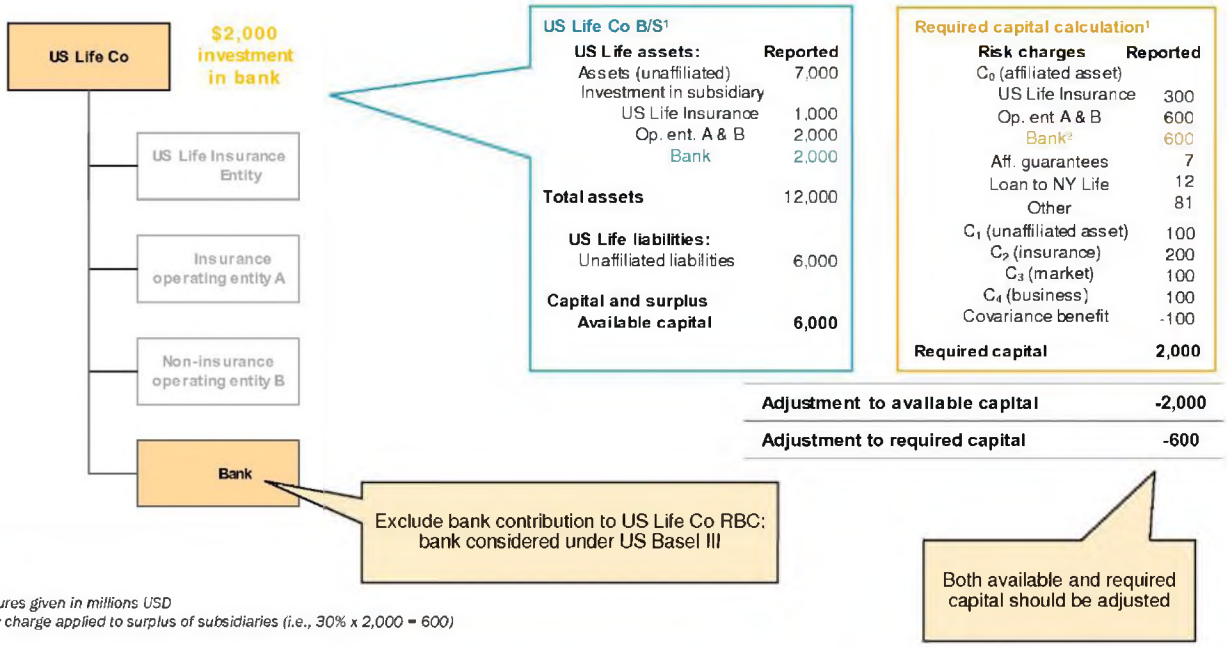
[X]% of TAR

Reserves

(100% – [X]%) of TAR

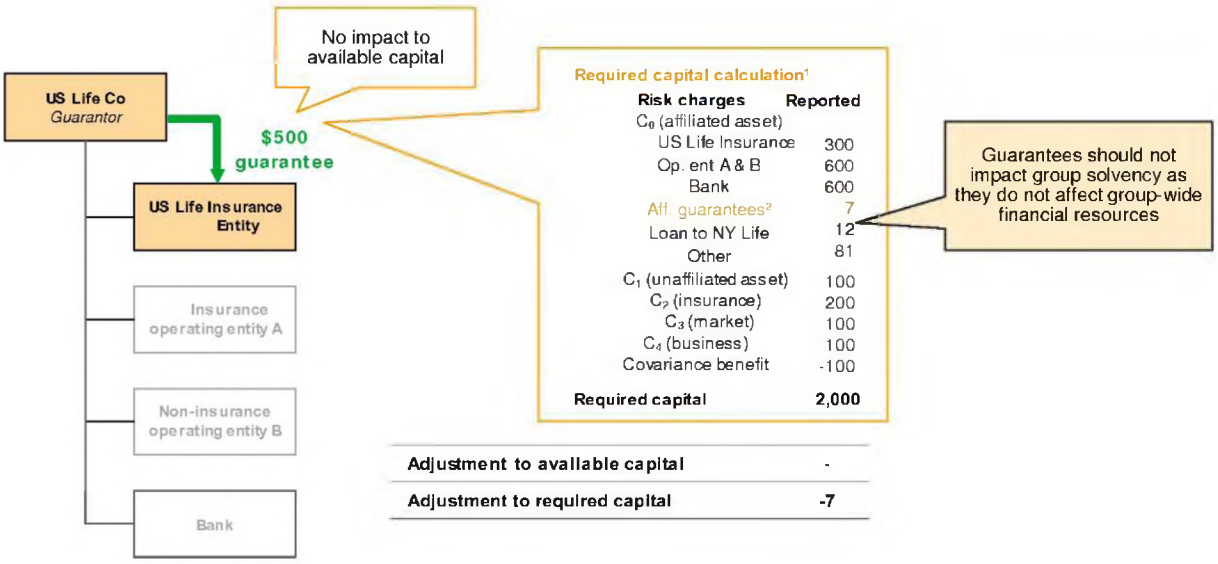
- The approach would apply to both captives and non-captives to ensure consistency
- **[X]%** would be a pre-calibrated percentage that stays fixed over time
- We expect that **[X]%** should be in the range of 1-1.5%

Figure 6: Illustration of investment in affiliate adjustment [Adjustment 5A]



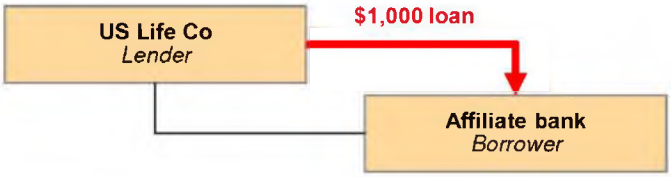
1. *All figures given in millions USD*
2. *Equity charge applied to surplus of subsidiaries (i.e., 30% x 2,000 = 600)*

Figure 7: Illustration of intragroup guarantee adjustment [Adjustment 5B]:



1. *All figures given in millions USD*
2. *Risk charge on intragroup guarantees of 1.3%*

Figure 8: Illustration of affiliate loan adjustment [Adjustment 5C]:



Available capital	6,000	900
Intercompany loan contribution to available capital	1,000 *Loan receivable*	(980) *Loan obligation*
Required capital	2,000	8,000
Intercompany loan contribution to required capital	4[1] *Loan asset risk charge*	-

Adjustment to group available capital	**-20**
Adjustment to group required capital	**-4**

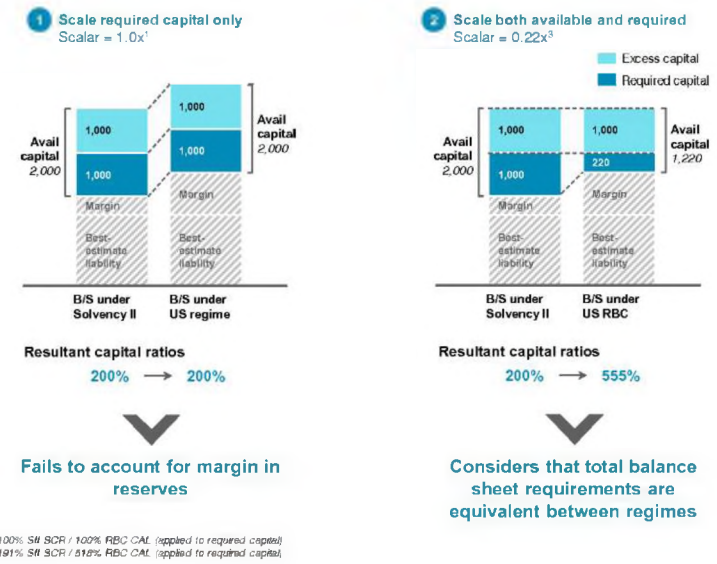
Adjust for difference in valuation of loan asset and loan obligation

Exclude risk charge for affiliate loan asset

1. *Risk charge on intercompany loans under RBC is 0.4%*

Figure 9a, 9b, 9c: Scalar Calibration and Application Illustration:

Comparison



1 Scalar = 100% Sll SCR / 100% RBC CAL (applied to required capital)
2 Scalar = 191% Sll SCR / 518% RBC CAL (applied to required capital)

Figure 9b.

Comparing Capital Regimes: Approach 1 – use single AC definition and scale RC

Approach 1 makes specific adjustments to definition of capital and required capital but may fail to holistically capture all factors (e.g. margin in reserves)

Illustrative example of two similar insurers – US and Europe
SMM

		US Insurer	EUR Insurer
Assets	Total assets [A]	4,000	4,000
Liabilities	Total liabilities [B]	2,700	1,800
	Insurance reserves	2,000	1,200
	Best estimate reserves	1,100	1,100
	Conservative margin	900	100
	Other liabilities / non-	700	600

1. Select large well-capitalized insurers, only life insurers used for US in this example
Note: RBC displayed is Company Action Level

Example of approach 1 for BBA – use single AC definition and scale RC

Adjustments	AC	RC
Starting capital (EUR)	2,200	1,150
Single definition of capital – exclude sub. debt	-100	-
Scale required capital – similar triggers so no adjustment made	-	-
Adjusted capital	2,100	1,150

183%

Results in capital ratio that is substantially lower than the 520% for a similar US insurer, even if required capital is scaled by 50%, the resulting 365% capital ratio is still much lower than the US insurer

Additional key facts / observations

	US	S II
Regulatory trigger	100%	100%
Average capital ratio (2014)[1]	518%	191%

Figure 9c.

Comparing Capital Regimes Approach 2 – scale both available and required capital

Approach 2 is a holistic approach that comprehensively accounts for all factors that affect both the numerator and denominator

	qualifying capital		
	Senior debt	*600*	*600*
	Subordinated debt	*100*	-
Capital	**Avail. capital [C] = [A] – [B]**	**1,300**	**2,200**
	Equity & surplus notes	1,300	2,100
	Subordinated debt	-	100
	Required capital [D]	**250**	**1,150**
	Local capital ratio [E] = [C] / [D]	**520%**	**191%**

1 Select large well-capitalized insurers, only life insurers used for US in the example
Note: RBC displayed is Company Action Level

Example of approach 2 for BBA – scale both AC and RC
Calibrated to regulatory trigger and operating ratio

Illustrative

Adjustments	AC	RC	
Starting capital	2,200	1,150	
Apply scalar to AC & RC – Considers differences in regulatory trigger and typical operating ratios	-897	-897	– *Effectively reallocates required capital as margin in reserves*
Adjusted capital	1,303	253	515%

The scalar approach considers holistic differences of both AC and RC across different regimes, and applies top level adjustments to account for these differences – this includes the 4 considerations discussed earlier (assets admitted, reserves, definition of qualifying capital and RC)

Resulting ratio is substantially closer to the US insurer

Additional key facts / observations

	US	S-II
Regulatory trigger	100%	100%
Average capital ratio (2014)[1]	518%	191%

Appendix 2: Cross-reference of responses to ANPR BBA-related questions

Question Number	ANPR Question	Reference section
6	What are the advantages and disadvantages of applying the BBA to the businesses and risks of supervised institutions significantly engaged in insurance activities?	**Sec. II B Part 1 and 3.**
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?	*See* **Sec. II B Part 1** (describing the benefits to developing, implementing and applying the BBA as well as reliance on existing systems and requirements); **Part 3** discusses additional benefits and challenges. **Sec. II B Part 2 (c)** (discussing utilization of existing records, data and systems). **Sec II B Part 2 (e).**
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?	*See* **Sec. II B Part 2 (e)(4)** (describing recommendations for the development, calibration and application of scalars). *See* **Sec. II B Part 2 (e)(3)** (describing appropriate adjustments).
9	To what extent is the BBA prone to regulatory arbitrage?	**Sec. II B Part 2 (e)** and **Part 3.**
10	Which jurisdictions or capital regimes would pose the greatest challenges to inclusion in the BBA?	**Sec. II B Part 2 (e)(4).**
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?	**Sec. II B Part 2.**
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?	**Sec. II B Part 1 and 2.**
13	Would the BBA be appropriate for larger or more complex insurance companies that might in the future acquire a depository institution?	**Sec. II B Part 2 (b)** and **Part 3.** *See also* **Sec. I.**
14	In applying the BBA, what baseline capital requirement should the Board use for insurance entities, banking entities, and unregulated entities?	**Sec. II B Part 2 (d)** and **(e)(7).**
15	How should the BBA account for international- or state-regulator-approved variances to accounting rules?	**Sec. II B Part 2 (e).**
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?	*See* **Sec. II B Part 2 (e)(3)** (describing appropriate adjustments and eliminations to ensure comparability when aggregating to an institution-wide level).
17	What approaches or strategies could the Board use to calibrate the various capital regimes without needing to make adjustments to the underlying accounting?	**Sec. II B Part 2 (e)(4).**
18	How should the BBA address intercompany transactions?	**Sec. II B Part 2 (e)(3).**
19	What criteria should be used to develop scalars for jurisdictions? What benefits or challenges are created through the use of scalars?	**See Sec. II B Part 2 (e)(4),(5),(6).** *See also* **Sec. II B Part 3.**

Question Number	ANPR Question	Reference section
		Sec. IIB Part 2(e)(4) describes criteria for the scalar development and the need to scale both available and required capital. **Part 2(e)(5)** and **(e)(6)** discuss the application of scalars to available and required capital. **Figures 9a, 9b, and 9c** in Appendix 1 compare regimes where both available and required capital are scaled with a regime where only required capital is scaled.
20	What are the costs and benefits of a uniform, consolidated definition of qualifying capital in the BBA?	**Sec. II B Part 2 (e)(5).**
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?	**Sec. II B Part 2 (e)(5).** See also **Figure 9b** in Appendix 1.
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?	**Sec. II B Part 2(e).** *See also* **Sec. II C** on page 25 (explaining why we do not believe tiering is appropriate for the CA or any group wide insurance capital framework).

Appendix 3: Cross-reference of responses to ANPR CA-related questions

Question Number	ANPR Question	Reference
23	What are the advantages and disadvantages of applying the CA to the businesses and risks of supervised institutions significantly engaged in insurance activities?	**Section I, Section II(A).**
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?	**Section I, Section II(A).**
25	To what extent would the CA be prone to regulatory arbitrage?	**Section I, Section II(A).**
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?	**Section I, Section II(A), Section II(C)** - Key considerations as to Qualifying Capital in a CA, Key considerations as to Required Capital in the CA.
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?	**Section II(C)** - Key considerations as to Required Capital in the CA.
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?	**Section II(C)** - Key considerations as to Qualifying Capital in a CA.
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?	**Section II(C)** - Key considerations as to Qualifying Capital in a CA.
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?	**Section II(C)** - Key considerations as to Required Capital in the CA.
31	What challenges does U.S. GAAP present as a basis for segmentation in the CA?	**Section I, Section II(C)** - Key considerations as to Qualifying Capital in a CA, Key considerations as to Required Capital in the CA.
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?	Not specifically addressed. Would be addressed if CA proceeds to future field testing.
33	How should the CA reflect off-balance-sheet exposures?	Not specifically addressed. Would be addressed if CA proceeds to future field testing.

Question Number	ANPR Question	Reference
34	Under what circumstances should U.S. GAAP be used or adjusted to determine the exposure amount of insurance liabilities under the CA?	**Section II(C)** - Key considerations as to Qualifying Capital in a CA.
35	What consideration should the Board apply in determining the various factors to be applied to the amounts in the risk segments in the CA?	**Section II(C)** - Key considerations as to Required Capital in the CA.
36	What challenges are there in determining risk factors for global risks?	**Section II(C)** - Key considerations as to Required Capital in the CA.
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?	Not specifically addressed.
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?	**Section II(D).**