FINANCIAL
SERVICES
ROUNDTABLE

September 16, 2016

Via e-mail

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
E-mail: regs.comments@federalreserve.gov

Re: Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities (RIN 7100-AE 53; Docket No. R-1539)

Dear Mr. Frierson:

The Financial Services Roundtable ("FSR")[1] welcomes the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB" or "Board") in connection with the Board's advance notice of proposed rulemaking on capital requirements for supervised institutions significantly engaged in insurance activities (the "ANPR").[2]

At the outset, FSR wishes to express its general support for the robust stakeholder responses to the ANPR from a number of other insurance trade associations and FSR member firms. We strongly believe that the ANPR process must be informed by robust and vigorous stakeholder dialogue, and therefore we are pleased that a number of stakeholders have provided detailed comments to the Board on various issues arising out of this important rulemaking. In this letter, we wish to offer general comments regarding

[1] As advocates for a strong financial future™, FSR represents the largest integrated financial services companies providing banking, insurance, payment and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

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

the Board's approach to establishing regulatory capital requirements for supervised insurers.

I. General Approach

A. Board Approach to Regulatory Capital Standards for Insurance Groups

FSR supports efforts to establish regulatory capital standards for Board-supervised insurance groups that are tailored to the business of insurance, and that recognize the fundamental role of state insurance regulators and state regulators' risk-based capital ("RBC") framework in ensuring the safety and soundness of these institutions. This approach is consistent with the clear and unambiguous Congressional mandate reflected in the Insurance Capital Standards Clarification Act ("ICSCA") for the Board to tailor capital requirements to the business of insurance, and to defer where appropriate to existing state insurance regulatory frameworks.[3]

FSR appreciates that the ANPR considers the Congressional mandate, acknowledging the "unique risks, regulation and balance sheet composition" of insurance groups, and that regulatory capital standards based solely on existing standards for banking organizations "would not capture significant insurance risks." We particularly appreciate that the ANPR appears to reflect the ICSCA's prohibition against applying GAAP-based regulatory capital standards to insurance groups that are required by law to file financial statements in accordance with Statutory Accounting Principles ("SAP").[4] We will continue to support these efforts and work with other stakeholders to ensure that any capital standards developed for SAP-reporting insurance groups fully reflect and preserve the state insurance regulatory and accounting frameworks that have protected policyholders and promoted the enterprise-wide safety and soundness of these firms.

Moreover, we wish to note that the long-standing, highly effective RBC framework, applied on legal entity basis, was specifically designed for use with financial information prepared in accordance with SAP. Accordingly, we believe it is critical that the ICSCA be interpreted and applied to cover situations where an insurance group may prepare audited U.S. GAAP consolidated financial statements for a holding company but does not have audited U.S. GAAP financial statements for its principal insurance operating legal entities to which the insurance RBC framework is applied. We believe that in those situations the insurance group should not be required to be evaluated on a U.S. GAAP basis as that would put an extraordinary operational and financial burden on insurers.

3 Pub. L. No.113-279, 128 Stat. 3017-3019 (codified at 12 U.S.C. § 5371).

4 12 U.S.C. § 5371(c)(3)(A).

In addition, we are pleased that the Board has analyzed potential alternative regulatory capital frameworks in connection with the issuance of the ANPR, including potential capital frameworks based on the European Solvency II framework. We agree with the Board's assessment that a Solvency II-based approach has the potential to introduce (i) excessive reliance on internal models, (ii) excessive volatility due to discount rate assumptions, and (iii) more generally, would face significant obstacles to implementation, particularly with respect to, as the Board notes, comparisons between firms and overall market and supervisory transparency.

B. Uniform Application of BBA to Supervised Insurers

The ANPR sets forth potential capital standards for two classes of insurance groups: (i) those that control an insured depository institution ("Insurance HCs") and (ii) those that have been designated as systemically important financial institutions ("Insurance SIFIs") by the Financial Stability Oversight Council pursuant to section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The ANPR describes in detail two potential capital frameworks for these firms:

- The first, the Building Block Approach (the "BBA"), would aggregate capital resources and requirements across different legal entities to calculate combined qualifying and required capital for the insurance group.

- The second, the Consolidated Approach (the "CA"), would categorize insurance liabilities, assets and certain other exposures into risk segments, determine consolidated required capital by applying a yet-to-be constructed and tested set of risk factors to the amounts in each segment, define qualifying capital for the consolidated firm, and then compare consolidated qualifying capital to consolidated required capital.

FSR believes that it would be appropriate for the Board to apply a single framework based on the BBA to all supervised insurance groups. A BBA-based framework offers a uniform and effective approach that has been analyzed and vetted by stakeholders and can be implemented and operationalized in a way that satisfies the Congressional mandate to tailor capital requirements to the business of insurance, while at the same time preserving scarce regulatory and industry resources and minimizing disparate and potentially overly punitive impacts arising out of an approach where the CA would apply only to Insurance SIFIs.

In this regard, FSR strongly believes that one of the most important attributes of the BBA is that it simply and effectively accounts for the various activities and risks of the different legal entities within a covered insurance group. In doing so, the BBA achieves the core supervisory objective of a group-wide regulatory standard, but does so by leveraging existing highly effective standards that are already tailored and calibrated to the activities and risks of the particular entity in question (e.g., depository institution or insurance underwriting subsidiary).

By contrast, establishing the CA as a viable construct will undoubtedly require significant additional investments of time, resources and energy. As the Board is aware, it has taken decades to develop consolidated capital standards for banking organizations, and we would expect that it would likewise take a substantial amount of time to develop a CA for Insurance SIFIs that contains the necessary detail to be a robust and workable framework. We respectfully urge the Board to consider whether it may be a more effective and efficient supervisory choice to apply the BBA to all firms, and apply capital and liquidity stress testing and other liquidity management principles to Insurance SIFIs to address potential macroprudential concerns.

In sum, uniform application of a BBA-based framework would be consistent with the ICSCA mandate to develop tailored standards for the insurance industry, simply and effectively address the activities and risks of the various legal entities within Insurance HC and SIFI groups, promote comparability across insurance groups, maximize efficiency, ease of implementation and monitoring, and minimize potentially punitive and disparate competitive impacts. For these reasons, we urge the Board to consider an approach whereby the BBA-based framework would be applied as a uniform standard to all supervised insurance groups.

If the Board is unwilling to adopt a BBA-based standard for all firms on a permanent basis, it should, at the very least, apply the BBA-based standard until the CA has evolved from its current status as a theoretical construct to a detailed and operational framework. The Board has an obligation to establish capital standards that preserve competitive equity to the greatest extent possible, and subjecting only two firms to a distinct and less-than-fully-developed standard violates this obligation. In any event, we urge the Board to in all events avoid the inappropriate and unfair imposition of the CA on Insurance SIFIs before it has been developed into a robust, detailed and workable standard that has been fully vetted through field-testing and quantitative impact analyses.

C. Equivalence Approach for Insurance HC RBC

When applying a BBA-based framework to supervised insurers, FSR urges the Board to consider an equivalence-type approach for Insurance HCs whose top-tier company is itself an insurance underwriting company. To be clear, while we oppose the application of a newly created consolidated insurance capital framework such as the CA, we do support an equivalence approach where the RBC ratio of the Insurance HC's top-tier holding company or set of top-tier operating companies, which include all the HC's subsidiaries, would be deemed to meet any FRB capital standard applicable to the firm, unless the Board makes an affirmative determination that the state RBC regime applicable to that firm is deficient.

FSR believes that looking to the capital strength of the top-tier holding company or set of operating companies as a proxy for the group as a whole is appropriate from a prudential perspective, in that, because all legal entities in the covered Insurance HC group are by definition subsidiaries of the top-tier insurance company, the RBC ratio of that company is reflective of the risks in the Insurance HC group. For example, the RBC ratio of the top-tier holding company would include risk-based capital charges for subsidiaries, thereby ensuring that the Insurance HC's capital ratio reflects the assets and risks of entities in the group.[5]

FSR acknowledges that such an equivalence framework may not appear to appropriately account for certain legal entities and risks in an Insurance HC group, particularly those relating to subsidiaries of an Insurance HC domiciled outside the United States. In this regard, the FRB would of course have broad discretion to modify or supplement as needed to address material risks not adequately accounted for in the relevant RBC ratio. FSR believes that the combination of (i) the Insurance HC top-tier operating company's RBC ratio and (ii) the FRB's broad authority to supplement this standard through supervisory action should be deemed sufficient to meet the FRB's objectives and Congress's direction under the ICSCA in establishing regulatory capital standards for these firms.

Finally, FSR urges the Board to consider the significant administrative benefits associated with this equivalence approach. Deferring to the RBC ratio of the Insurance HC's top-tier holding company or operating companies will obviate the need to calculate regulatory capital regimes for each legal entity, and to apply the various adjustments to these baseline calculations contemplated by the BBA. Covered Insurance HCs could qualify for a "single block" approach where all of its operations are aggregated under a top-tier insurance holding company. By taking as its basis the RBC requirements of the insurance group's top-tier company or companies, the equivalence approach offers an administratively efficient framework for applying capital standards to Insurance HCs whose top-tier holding company is a regulated insurance underwriting company, accounts for risks throughout the Insurance HC group, and is consistent with the clear Congressional mandate in the ICSCA for the FRB to tailor capital requirements to covered insurance groups.

[5] We recognize that certain subsidiaries at times may be excluded from the top-tier company's RBC ratio. For example, the RBC framework for life insurance companies, in practice, excludes certain non-U.S. and non-Canadian subsidiaries from the top-tier company's RBC ratio.

II. Specific Comments on the BBA

A. Criteria for Inclusion

The Board seeks comment in the ANPR on the criteria used to determine which supervised insurers should be subject to tailored capital standards, and notes the option of using the current thresholds set out in Regulation Q, pursuant to which an Insurance HC would be subject to tailored capital requirements if it (i) is an insurance underwriting company or (ii) held 25 percent or more of its assets in subsidiaries that are insurance underwriting companies (other than assets associated with insurance for credit risk).[6]

FSR believes that Regulation Q appears to establish appropriate thresholds for application of Board capital standards tailored to insurance groups. For this reason, we would expect any Board-supervised insurance group that meets the above thresholds to be subject to a capital standard based on the BBA, rather than the generally applicable regulatory capital standards for banking organizations.

B. The BBA and Potential Regulatory Arbitrage

The ANPR requests comment on the extent to which the BBA may be prone to regulatory arbitrage. As discussed below, FSR believes that multiple factors suggest that any potential for regulatory arbitrage with respect to the BBA would be mitigated. These factors include the FRB's broad existing supervisory authority and various attributes of the state and international regulatory and reporting regimes relating to the insurance sector. FSR urges the FRB to analyze these factors holistically and to consider how the combination of federal, state and international actions will serve as a significant and robust counterweight to the potential for regulatory arbitrage that could undermine the policy objectives of the ANPR.

FSR believes the Board should, in the first instance, look to its broad supervisory authority over Insurance SIFIs and HCs as a powerful deterrent against potential regulatory arbitrage. The Board will undoubtedly seek to analyze and understand activities of and transactions conducted by covered insurance groups as part of its normal-course supervisory activities, and we would expect this process will act as a natural deterrent against arbitrage-like changes that run counter to the Board's supervisory objectives with respect to the BBA.

Second, the rules for the calculation of risk-based capital ("RBC"), the primary measure of capital used by U.S. insurance regulators, are set out in model National Association of Insurance Commissioners (the "NAIC") laws and regulations. Adoption of and adherence to these model laws and regulations is a requirement for a state to

[6] See 12 C.F.R. 217.2.

remain accredited with the NAIC, a very important status. Currently all states are NAIC-accredited. This accreditation requirement acts as an effective check on any effort by an individual state to create avenues for material deviation or arbitrage with respect to the insurance RBC components of the BBA.

Third, existing state-based regulatory regimes for insurance holding companies subject covered firms to robust and increasingly rigorous inter-jurisdiction and group-wide regulatory and reporting requirements. These regimes were adopted following many years of intensive and extensive debate, crafting and effort by state regulators and the NAIC. For example, extensive coordination between and among the U.S. states in the supervisory process for multi-state insurance groups, including through the establishment and use of "lead state" supervisors and supervisory colleges, ensures that the state-based supervisory process takes account of the group structure and dynamic, rather than focusing exclusively on the insurance company in a particular jurisdiction. Similarly, the NAIC Insurance Holding Company System Regulatory Act, which subjects material inter-affiliate transactions to regulatory review and disapproval, and the Risk Management and Own Risk and Solvency Assessment Model Act, which requires Insurance HCs and Insurance SIFIs to provide enterprise-level risk reporting and analysis to the group's state insurance regulators, provides these firms' state insurance regulators with an enterprise-wide view of the firm and the ability to proactively mitigate and avoid inconsistent practices in particular jurisdictions that could give rise to regulatory arbitrage. We expect that the NAIC and individual states will continue to emphasize these and other initiatives to enhance group-wide regulation of Insurance HCs and SIFIs, and that such initiatives will reinforce the NAIC and state systems' role as effective checks on potential regulatory arbitrage within the BBA.

Finally, there are effective and evolving mechanisms for minimizing risks of regulatory arbitrage between and among the various jurisdictions in which Insurance SIFIs and HCs do business. For example, the Basel Committee on Banking Supervision (the "BCBS") regularly assesses individual jurisdictions' compliance with international capital standards, and the International Monetary Fund's ("IMF") Financial Sector Assessment Program ("FSAP") provides detailed and transparent information on the financial sectors of particular jurisdictions.[7] We expect that these and other similar mechanisms will help to reduce the possibility of regulatory arbitrage on a cross-border basis.

[7] See http://www.bis.org/bcbs/implementation/bprll.htm (BCBS implementation monitoring); http://www.imf.org/external/NP/fsap/fsap.aspx (IMF FSAP).

C. Scalars

The ANPR contemplates the use of scalars as a mechanism for bringing different jurisdictional capital frameworks to comparable levels of supervisory stringency, with the Board requesting comment on benefits and challenges of such an approach.

FSR agrees that scalars are a useful tool for comparing (i) non-U.S. regulatory capital frameworks with the U.S. system and (ii) regulatory capital frameworks applicable to different types of regulated entities, e.g., insurance underwriting companies vs. insured depository institutions, and supports their inclusion in the BBA for these purposes. As the Board continues to develop an analytical framework for their use, FSR urges continued focus on the development of a scalar framework that is as efficient, simple and transparent as possible, and provides for as uniform treatment as possible for substantially similar regulatory capital regimes, particularly with how they compare to the U.S. state RBC frameworks.

III. Conclusion

Thank you for consideration of our comments. FSR and its members welcome and look forward to continuing dialogue with the Federal Reserve on these issues. If it would be helpful to discuss this matter further, please contact me via telephone at (202) 589-2424 or e-mail at Richard.Foster@FSRoundtable.org.

Sincerely Yours,

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