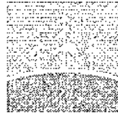

The Cypress Group

July 22, 2016

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RE: **Incentive-based Compensation Arrangements** (FRB Docket No. 1536 and RIN No. 7100 AE-50; OCC Docket ID OCC-2011-0001; SEC File No. S7-07-16; and FDIC RIN 3064-AD86) (81 FR 37670, Jun. 10, 2016)

Dear Sirs or Madams:

I write on behalf of The Insurance Coalition, a group of federally supervised insurance companies and interested parties. We share a common interest in federal regulations that apply to insurance savings and loan holding companies ("insurance SLHCs"). In this case, we write because as insurance SLHCs, many Insurance Coalition members would be directly subject to the pending notice of proposed rulemaking ("NPR") on incentive-based compensation arrangements.

Our comments below are specific to the application of the NPR on insurance SLHCs. We also support the comments of our member company trade associations, including the American Council of Life Insurers (ACLI) and the Financial Services Roundtable (FSR).

Executive Summary

The Federal Reserve Board ("the Board") has already recognized that insurance SLHCs do not pose systemic risk[1]. Therefore, we believe it is appropriate to exclude insurance SLHCs from the application of the NPR, because in our view the existing guidelines in place for insurance SLHCs satisfy the statutory requirements under Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act")[2]. Excluding insurance SLHCs from the final rule is consistent with the Board's stated desire to tailor regulations to the business of insurance, and the 2013 exclusion of insurance SLHCs from the final rule implementing the Basel III bank capital requirements.[3]

As an alternative to excluding insurance SLHCs from the final rule, we request that the Board exclude insurance assets from the definition of "average total consolidated assets" in determining the "Level" of these financial institutions under the NPR. Absent these changes, many insurance SLHCs would be categorized as Level 2 institutions and subject to mandatory deferral, forfeiture, clawback, and other onerous requirements that are inappropriate given their risk profile.

We believe our suggested approaches are consistent with congressional intent, with the Board's regulatory policy regarding tailoring regulations to the business of insurance, and the Board's view that insurance SLHCs are smaller, less complex financial institutions.[4] Our approaches would also prevent significant competitive dislocations resulting from applying incentive-based compensation restrictions to a subset of the insurance industry. Under either of our approaches, insurance SLHCs would still be subject to the Board's 2010 Guidance on Sound Incentive Compensation Practices ("2010 Guidance"), which the Board could appropriately tailor to the individual institution to examine their incentive-compensation practices. Additionally, the Board could still rely on its broad supervisory powers to address any concerns with executive compensation practices within any of the 12 insurance SLHCs.

Should the Board decide not to provide a full exclusion for insurance SLHCs and provide an exclusion only for insurance assets, then we believe that insurance subsidiaries should be excluded from any application of the final rule. There is precedent within the NPR for excluding other functionally regulated subsidiaries – the Securities and Exchange

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[1] The Ins. Capital Standards Clarification Act of 2014, Pub. L. No. 113-279, 128 Stat. 3017 (2014).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).

[3] Daniel K. Tarullo, Board Member, Fed. Reserve, Speech at the Nat'l Ass'n of Ins. Comm'r's Int'l Ins. Forum, Washington D.C. (May 20, 2016); Janet Yellen, Chairman, Fed. Reserve, Opening Statement on Ins. Capital Advanced Notice of Proposed Rulemaking and Enhanced Prudential Standards Proposed Rule for Systemically Important Ins. Firms (June 3, 2016); Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Mkt. Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Mkt Risk Capital Rule, 78 Fed. Reg. 62018 (proposed Oct. 11, 2013) (to be codified at 12 C.F.R. Parts 208, 217, and 225) [hereinafter Basel III].

[4] As noted in previous comment letters, the Insurance Coalition takes the position that no insurer poses systemic risk.

Commission (SEC) rule excludes investment adviser and broker-dealer subsidiaries. Excluding insurance subsidiaries would also avoid interference with the state insurance regulatory framework, as well as a statutory authority/construction issue regarding the rule's enforcement regime. We also believe that excluding insurance subsidiaries is appropriate from a policy perspective, because the insurance subsidiaries of insurance SLHCs, like their parent companies, do not pose systemic risk.

Under either of our proposed approaches, any subsidiary thrifts over $1 billion in assets would remain subject to the rule, as would any non-insurance financial subsidiary that is otherwise a covered financial institution under the rule. However, we would expect that any application of the NPR to these subsidiaries would be based solely on the asset size and risk profile of the individual "covered financial institution" subsidiary.

We believe that either of our proposed approaches reflects the intent of Congress to tailor federal regulations to insurance, complements rather than disrupts the state regulatory framework, and does not pose concerns regarding systemic risk.

I. The Data Informing the Rule is Bank-Centric and Excludes Insurers

In enacting section 956 of the Dodd-Frank Act, Congress sought to ensure that incentive-based compensation practices would not contribute to a future financial crisis.[5] In explaining that goal and the goal of the NPR, the Board notes that executive compensation plans should be designed to attract and retain key staff and promote the health of financial institutions.[6] We agree strongly with these goals.

However, we believe that any incentive-based compensation restrictions applied to insurance SLHCs should be tailored to the business of insurance and insurance compensation practices. The NPR is squarely focused on banking organizations, and large interconnected banking organizations in particular.[7] The NPR does not include any analysis of material risks in insurance SLHCs, insurers' current incentive-based compensation practices, or the work of other insurance supervisors in this arena. We believe that such analysis should be undertaken before the rule is finalized.

A. The Rule's Analysis is Focused on Complex Banking Institutions.

The analysis underpinning the rule is almost solely focused on complex banking organizations, because of the perception that incentive compensation practices at such firms contributed to systemic risk before the financial crisis. The preamble of the rule

[5] See Fed. Reserve, Incentive-based Compensation Arrangements 16-20 (2016), https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160502a2.pdf. [hereinafter 2016 Proposed Rule] (explaining that Section 956 of the Dodd-Frank Act requires that "the Agencies prohibit any types of incentive-based compensation agreements" and that "there is evidence that flawed incentive-based compensation practices in the financial industry were one of the many factors contributing to the financial crisis that began in 2007.").
[6] *Id.*, at 20.
[7] 2016 Proposed Rule, *supra* note 4, at 1-365.

notes that "large financial institutions in particular are interconnected with one another and with many other companies and markets, which can mean that any negative impact from inappropriate risk-taking can have broader consequences."[8] Throughout the rule, specific roles at banking organizations are identified as being able to expose a financial institution to significant risk. These roles include traders with large position limits, underwriters, and loan officers..." as well as "individual traders or trading groups."[9] The specific hypothetical examples used in the rule to illustrate how it would be implemented are also bank-centric– "Ms. Ledger" is the chief financial officer at a bank holding company and "Mr. Ticker" is the senior manager of a trader and a trading desk at a bank.[10]

B. The Horizontal Reviews Excluded Insurers.

Further, the specific analyses underpinning the rule did not include any analysis of insurance companies, including companies subject to the rule. The Horizontal Review that informed the rule included 25 large, complex banking organizations and no insurers.[11] The NPR notes that "[o]ne goal of the Horizontal Review is to help improve the Federal Banking Agencies' understanding of the range and evolution of incentive-based compensation practices across institutions and categories of employees within institutions."[12] However, this was only undertaken with respect to large banks. The focus on these organizations is appropriate given the goals of the rule, but reflects a lack of analysis regarding the appropriate treatment of insurance SLHCs.

Furthermore, the second Horizontal Review that informed the rule was also entirely bank-centric. The 2012 large banking organization review ("2012 LBO Review") focused on 12 additional large banking organizations, and no insurers.

C. Supervisory Experience and Coordination with Other Regulators is Bank-Centric and Does not Include other Insurance Supervisors.

The rule cites supervisory experience and horizontal reviews as an important source of data informing the NPR.[13] However, as noted above, the horizontal reviews did not include any insurers, and the NPR itself notes "supervisory oversight focuses most intensely on large banking organizations because they are significant users of incentive compensation and because flawed approaches at these organizations are more likely to have adverse effects on the broader financial system."[14]

Additionally, the Board cites experience with other supervisors, including international groups, as a source of support for the rule. However, none of the groups listed are

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[8] *Id.*
[9] 2016 Proposed Rule, *supra* note 4, at 21.
[10] *Id.*, at 281-302.
[11] *Id.*, at 25
[12] *Id.*, at 25.
[13] 2016 Proposed Rule, *supra* note 4, at 24-25.
[14] *Id.*, at 27.

insurance-specific.[15] Indeed, it appears that there was no significant coordination with state insurance commissioners, the National Association of Insurance Commissioners (NAIC), or the International Association of Insurance Supervisors (IAIS) in drafting the rule.[16]

We also note that the lack of coordination departs from the Board's practices in other areas regarding insurance regulations – most notably, the significant and successful consultation with insurance supervisors before the release of the Advanced Notice of Proposed Rulemaking ("ANPR") on insurance capital on June 3, 2016. In that case, the Board consulted directly with state insurance supervisors and has participated directly in work streams on insurance capital at the IAIS. The resulting ANPR reflects that collaboration and is tailored to insurance. In this case, we believe that consultation and coordination with state insurance commissioners would help insure that any supervisory standards developed for the insurance industry are reflective of the risks and compensation practices in insurance.

II. The Final Rule should Exclude Insurance Assets

As noted above, we believe that insurance SLHCs should be excluded from the scope of these regulations because they are not targeted at, or tailored to the business of insurance. We believe this can be achieved in one of two ways – either excluding insurance SLHCs themselves, or excluding insurance assets in the determination of the "Level" of an insurance SLHC. We believe this is consistent with the intent of Congress and the policy goals of the rule.

A. Congress has Consistently Indicated that Insurance Should be Treated Differently.

Congress has consistently indicated its intent to treat insurers differently in financial regulation. This is in part because the business of insurance is highly distinct from banking, and also a recognition of the robust regulation of insurance at the state level. Congress codified the deference to states in the regulation of insurance in the McCarran-Ferguson Act[17], and has consistently sought to avoid disruption of the state regulatory regime in federal regulation.

Congress's intent to protect the state regulatory framework and tailor to the business of insurance is apparent throughout the Dodd-Frank Act. For example, the Volcker Rule

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[15] *Id.*

[16] Coordination with the NAIC and state insurance commissioners is particularly critical because the NAIC and the states have already completed significant work on corporate governance issues, including incentive-based compensation. In 2008, the NAIC undertook the Solvency Modernization Initiative, a regulatory project that included a Corporate Governance Working Group, which developed a Corporate Governance Model Disclosure Act. The NAIC is expected to adopt that Model Act as part of its accreditation standards. Adoption of the Model Act is well underway in the states. *See Solvency Modernization Initiative: What is the Solvency Modernization Initiative (SMI)?*, NAT'L ASSN. OF INS. COMM'R'S (Aug. 25, 2013), http://www.naic.org/index_smi.htm

[17] 15 U.S.C. §§ 1011-1015 (1945).

restrictions were targeted at banks and certain bank business practices, and the final rule appropriately excluded the business of insurance.[18] Additionally, Congress intended for the Board to tailor its capital regulation for insurance, which was clarified in the 2014 Insurance Capital Standards Clarification Act.[19]

B. Insurance SLHCs do not Pose Systemic Risk.

Here, while the statute does not require specific provisions to be applied to insurance SLHCs, it is consistent with the intent of Congress in the Dodd-Frank Act and with the policy goals of the rule to treat insurers differently. As the NPR notes, a major focus of the rule and the Board's supervisory efforts has been to contain systemic risk and prevent incentive-based compensation plans from contributing to systemic risk.[20]

It is consistent with these policy goals to treat insurance SLHCs differently than other covered financial institutions because the Board has indicated that insurance SLHCs do not pose systemic risk. In the June 3 release of its ANPR on insurance capital, the Board noted, these companies are "less complex, less international, and do not pose systemic risk."[21]

As one senior Board official noted, "[a]mong the institutions that the board supervises, those that significantly engage in insurance activities are different from banks in terms of their business model and risk profile. And the most appropriate supervisory and regulatory approach for these firms is one that best reflects the risks of the business of insurance and is proportional to the threat that the firm poses to financial stability."[22]

In addition to the need to tailor rules for insurance SLHCs because they do not pose systemic risk, we also believe that tailoring the rules comports with the Board's prior policy on incentive compensation. Specifically, the Board acknowledged the need to avoid a one-size-fits-all approach to incentive-based compensation restrictions, not just for insurance, but generally, in its 2010 Guidance. As noted in the final guidance:

> [t]he Agencies believe this [principles-based] approach is the most effective way to address incentive compensation practices, ***given the differences in the size and complexity of banking organizations covered by the guidance and the complexity, diversity, and range of use of incentive compensation arrangements by those organizations***. For example, activities and risks may vary significantly across banking organizations and across employees within a particular banking organization. For this reason, ***the methods used to achieve appropriately risk-sensitive compensation arrangements likely will differ across and within***

[18] 12 U.S.C. § 1851 (2011).

[19] The Ins. Capital Standards Clarification Act of 2014, Pub. L. No. 113-279, 128 Stat. 3017 (2014).

[20] 2016 Proposed Rule, *supra* note 4, at 30-31.

[21] Capital Requirements for Supervised Inst. Significantly Engaged in Ins. Activities, 81 Fed. Reg. 38634 (proposed June 14, 2016) (to be codified at 12 C.F.R. ch. 2).

[22] Board of Governors of the Federal Reserve System, *Open Board Meeting June 3, 2016* (ALL IN ITALICS), 5:09-5:27 (June 3, 2016), http://www.federalreserve.gov/aboutthefed/boardmeetings/20160603openmemos.htm

> ***organizations, and use of a single, formulaic approach likely will provide at least some employees with incentives to take imprudent risks.*** (emphasis added).[23]

We believe that this philosophy should inform the treatment of insurers in the final rule, because applying substantive restrictions to 12 insurance SLHCs would create distortions in the insurance industry to a much greater extent than application of such rules to all banks with over $1 billion in assets.

C. The Board has the Statutory Flexibility to Exclude Insurance SLHCs and Insurance Assets.

We believe that in addition to serving important policy goals, the Board has the statutory authority to tailor incentive-based compensation rules for insurers. Just as the ANPR on capital reflects the characteristics of insurance SLHCs and the fact that they do not pose systemic risk, so too should the final rule on incentive-based compensation. The statute permits this distinction, and it is consistent with long-standing congressional intent regarding insurance regulation.

Section 956 of the Dodd-Frank Act applies to "covered financial institutions" and defines covered financial institutions to include insurance SLHCs.[24] Thus, the Board is required to "prescribe regulations or ***guidelines***" that "prohibit any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions..."[25]

Other than those parameters, the plain language of the statute does not require that specific restrictions apply to insurance SLHCs, nor does it require that the same restrictions apply to insurance SLHCs as to other covered financial institutions.[26]
Section 956(c) provides standards for development of regulations prohibiting excessive compensation and compensation that could lead to material loss[27], but there is no reference in the statute regarding specific restrictions, including the restrictions in the NPR - mandatory deferral, forfeiture and clawbacks.[28]

In addition, Section 956(c) ties any standards for compensation under Section 956 to other standards that require regulators to undertake a comparison of compensation practices by business line. Specifically, Section 956(c)(1) requires that the agencies take into consideration the compensation standards described in the Federal Deposit Insurance Act ("FDIA").[29] The relevant section of the FDIA requires the agencies to prescribe compensation standards specifying when compensation is "excessive" by considering, inter

[23] Guidance on Sound Incentive Comp. Policies, 75 Fed. Reg. 36399 (proposed June 25, 2010).
[24] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o)
[25] *Id.*
[26] *Id.*, at § 956(d).
[27] *Id.*, at § 956(c).
[28] *Id.*
[29] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956(c)(1).

alia, "comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the loan portfolio or other assets."[30]

While Section 956 does not explicitly require that the Board consider "comparable compensation practices,"[31] by incorporating the FDIA and requiring that the Board take that statute's standards into account, we believe that Congress intended that the Board consider the factors laid out in the FDIA when developing compensation standards under Section 956, since Section 956 directly incorporates the FDIA standards.[32] Indeed, in promulgating the NPR, the Board did consider "comparable compensation practices at comparable institutions" in the banking sector, as evidenced by the horizontal reviews, but did not do so for insurers, as noted above.

Congress did not specify that regulations or guidelines promulgated under Section 956 must be uniform across all categories of covered financial institutions, and in fact, the FDIA standards incorporated by reference require the agencies to consider practices within industries. Thus, it is not only permissible, but desirable and consistent with congressional intent, for the Board to tailor the rules for insurance SLHCs. We believe that the most effective means for doing so would be to exclude insurance SLHCs from the scope of the proposed rules. This would preserve the Board's ability to utilize supervisory guidance/guidelines to examine the incentive-compensation practices at these institutions. Because, as noted above, the statute explicitly contemplates the use of guidelines to fulfill the requirements of Section 956, we believe that the Board has met its statutory obligation by applying the 2010 Guidance to insurance SLHCs. We also believe that reliance on the 2010 Guidance and other supervisory tools is permissible under the statute and appropriate for insurance SLHCs, because insurance SLHCs do not pose systemic risk and practices that could cause material financial loss in an insurer are wholly distinct from those at complex banks.

As an alternative to excluding insurance SLHCs from the rule, we believe that the Board should consider excluding insurance assets from the calculation of total consolidated assets for the purpose of determining an insurance SLHC's "Level." This approach would ensure that insurance SLHCs are not subject to the NPR's overly prescriptive standards designed for complex banks.

D. The NPR would Create Inappropriate Outcomes in Insurance.

Because the NPR only applies to a small subset of insurance companies, it would create unintended competitive distortions in the industry. As drafted, the NPR would – but only for the insurance SLHC subset - capture hundreds of insurance professionals that manage and mitigate, rather then generate, risk. For example, according to our analysis the deferral restrictions on Level 2 institutions would sweep in attorneys, compliance professionals,

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[30] Fed. Deposit Ins. Act, 12 U.S.C. 1811 §39 (2015).

[31] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956.

[32] *Id.*, at § 956(c)(2).

enterprise risk management, and underwriting professionals. As is clear from the examples in the NPR, the rule is targeted at roles in complex banking organizations including roles that, even if not the highest paid, have the ability to expose the bank to significant risk. For example, the rule cites bank loan officers and traders.[33] These banking functions do not exist in insurance companies, and many of the insurance functions that are inadvertently targeted by the rule mitigate risk rather than generating it. In fact, the NPR may be both over-and under-inclusive as regards insurance SLHCs, because it sweeps in risk-mitigating functions within insurance companies but does not consider what other functions or individuals within insurance companies could expose the companies to significant risk, and how best to tailor incentive-compensation controls to mitigate any risk. This underscores the need to link any rulemaking on incentive-based compensation for insurance SLHCs to a thorough analysis of the risks at insurers, incentive-based compensation practices in the industry, and coordinate with other insurance supervisors, which has yet to be undertaken.

The rule would also make it more difficult for insurance SLHCs to attract and retain top-flight professionals for these roles, because of the mandatory deferral, downward adjustment, forfeiture and clawback requirements that would be imposed.[34] In our view, the Board should avoid overly prescriptive, bank-centric incentive-based compensation restrictions on a subset of insurers.

In addition to creating distortions within the insurance industry, we believe that any safety and soundness benefit derived from the imposition of the NPR on insurance SLHCs would be significantly outweighed by the costs imposed on these institutions. The Board has already concluded that these insurers do not pose systemic risk. We agree and believe that because insurance SLHCs do not pose systemic risk, imposing mandatory deferral, downward adjustment, forfeiture and clawback restrictions on these institutions would not significantly reduce systemic risk. Rather, such restrictions would produce only costs (cost of compliance, competitive distortions) with, in our view, no material benefit in terms of improving safety and soundness reducing systemic risk. A better safety and soundness benefit can be achieved through the use of a principles-based supervisory approach that can be appropriately tailored to the individual institution being supervised. The Board demonstrated a sensitivity to the cost not outweighing the benefits of regulation on insurance SLHCs in its ANPR on insurance capital, and we believe such sensitivity is warranted here.

While the NPR does not reflect consideration of the consequences of imposition of the rule on insurance SLHCs, we believe that the Board is required to do so before the rule is made final. In *Michigan v. Environmental Protection Agency*, the Supreme Court noted that the statute in question statute directed the EPA to regulate emissions from power plants if the agency deemed them "appropriate and necessary."[35] The Court held that the EPA could not refuse to consider the cost to power plants when finding that the agency's regulation was

[33] 2016 Proposed Rule, *supra* note 4, at 20.
[34] 2016 Proposed Rule, *supra* note 4, at 44-48.
[35] *Michigan v. EPA*, 135 U.S. 2699, 2701 (2015).

"appropriate and necessary."[36] The Court noted that "[i]t is not rational, never mind "appropriate," to impose billions of dollars in economic costs in return for a few dollars in health or environmental benefits."[37]

Here, *Section* 956 directs the agencies to prohibit inventive-based compensation arrangements or features of arrangements that encourage "inappropriate risk."[38] The statute also requires the regulators to ensure that standards are "comparable" to the standards established under the Federal Deposit Insurance Act.[39] As in *Michigan v. EPA*, where the Court found that the EPA's determination that a regulation was "appropriate"[40] must include an analysis of the cost of the regulation; here, too, we believe that the determination of whether an insurer's incentive-based compensation arrangement encourages "inappropriate" risk should include an analysis of the cost of compliance and restrictions to the institution. As the Court noted in *Michigan v. EPA*, agencies are required to engage in "reasoned decision making"[41] and "agency action is lawful only if it rests 'on a consideration of the relevant factors."[42] Here, we believe that "reasoned decision making" and a "consideration of the relevant factors" require the Board to consider both the specific risk profile of insurance SLHCs and the cost of the rule to those institutions. As the *Michigan v. EPA* court noted, "[n]o regulation is 'appropriate' if it does significantly more harm than good,"[43] and we are concerned that application of the NPR to insurance SLHCs could unintentionally do more harm than good to those companies and the insurance industry generally.

Beyond its direct application to insurance SLHCs, we also believe that the scope of the NPR exceeds the Board's statutory authority under a *Michigan v. EPA* analysis. Under the statute, the agencies are charged with regulating any incentive-based compensation system that "encourages inappropriate risk."[44] Rather than focusing solely on such compensation systems, the agencies seek to regulate all variable compensation systems (subject to the one-third and 5% thresholds), without regard to whether any particular variable compensation system "encourages inappropriate risk." Because the NPR is not tightly tethered to any specifically articulated notion of inappropriate risk or whether an incentive-based compensation arrangement encourages such risk, we believe the NPR does not comport with the *Michigan v. EPA* mandate of "reasoned decision making." In the case of insurance SLHCs, for example, the NPR would sweep in incentive-based compensation plans that are entirely linked to the performance of the enterprise and in no way linked to the individual's performance. Such a plan cannot be said to encourage inappropriate risk-taking on the part of an individual, but would be captured under the NPR.

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[36] *Id.*, at 2712.
[37] *Id.*, at 2701.
[38] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956.
[39] *Id.*, at § 956(c)(2).
[40] *Michigan v. EPA*, at 2702.
[41] *Id.*, at 2706.
[42] *Id.*, at 2701 (quoting *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U. S. 29, 43 (1983)).
[43] *Michigan v. EPA*, at 2707.
[44] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956(b).

E. Our Proposed Approaches

Given all of the above, it is appropriate from a policy perspective and consistent with the intent of Congress to tailor the final rule to the business of insurance. Specifically, we suggest that the Board apply a 25-percent-of-assets-in-insurance-underwriting test to determine which firms are insurance SLHCs for purposes of tailoring. This is consistent with the Board's prior rulemaking tailored to insurance and describes firms that, as the Board notes, are significantly engaged in insurance.[45] In the case of this rulemaking, we believe that all 12 insurance SLHCs meet this 25-percent test, and no other covered financial institution would.

We request that the Board exclude insurance SLHCs that meet this 25-percent test from the final rule insurance because the rule is not appropriate for or tailored to insurance. Alternatively, we request that the Board exclude insurance assets from the definition of total consolidated assets, which under the NPR is used to determine the "Level" of an institution. In addition, we request that the Board consider the risk profile of any insurance SLHCs that remains a Level 2 institution after insurance assets are excluded. For example, in our view, insurance SLHCs that do not engage in commercial lending should be treated as Level 3 institutions. This is consistent with the Board's authority under the NPR to adjust the "Level" of an institution downward to reflect its actual risk profile.[46]

If insurance SLHCs were categorized as Level 3 institutions, they would continue to be subject to the NPR's board of directors oversight, recordkeeping, and other requirements, and the NPR's general prohibition on excessive compensation and arrangements that create material financial loss.[47] Under our proposed changes to the NPR, the Board would also retain its existing tools to address incentive compensation at insurance SLHCs. Specifically, insurance SLHCs would remain subject to the Board's 2010 Guidance.[48] Moreover, the Board can at any time rely on its broad supervisory powers to identify and require changes to insurance SLHCs' incentive-based compensation arrangements, including through ongoing supervision and examination, and the use of Matters Requiring Attention or Matters Requiring Immediate Attention.[49]

We believe that these existing supervisory tools and the restrictions imposed on Level 3 institutions are sufficient to meet the NPR's goals of containing systemic risk, and meet the policy goal of tailoring for the business of insurance.

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[45] Basel III, *supra* note 2, at 62020; Capital Requirements for Supervised Inst. Significantly Engaged in Ins. Activities, 81 Fed. Reg. 38631 (proposed June 2016) (to be codified 12 C.F.R. ch. undefined).
[46] 2016 Proposed Rule, *supra* note 4, at 47-48.
[47] *Id.*, at 176.
[48] Fed. Reg. 36399, *supra* note 17, at 36395-36414.
[49] Board of Governors of the Fed. Reserve System , *Supervisory Considerations for the Commc'n of Supervisory Findings* para 1-4 (2013), https://www.federalreserve.gov/bankinforeg/srletters/sr1313.htm.

F. For the Federal Reserve to Exclude Insurance Assets is Consistent with the SEC's Treatment of Investment Advisers

We have suggested above that the Board exclude insurance company assets from total consolidated assets for purposes of determining an institution's "Level." In determining total consolidated assets for investment advisers, the SEC's version of the proposed rule excludes non-proprietary assets, such as client assets under management, whether on- or off-balance-sheet.[50] The proposed rule references Section 956(f) as support for this calculation method, because that section merely references "assets".[51]

We believe that for the Board to exclude insurance assets is consistent with the SEC's calibrated approach to the treatment of investment advisers. It is entirely consistent with the letter and the intent of the statutory provision to tailor the incentive compensation rules to the industry in question by excluding assets as appropriate. Under our proposal, any subsidiary insured depository institution over $1 billion (or other non-insurance covered institution) at an insurance SLHC would remain independently subject to the NPR, which is appropriate and reflects the policy goals of the rule.

III. The Final Rule Should Exclude Insurance Subsidiaries

Because insurance thrift subsidiaries are functionally regulated by states, application of the rule to these subsidiaries raises special concerns. As noted above, Congress evinced an intention to tailor regulations to the business of insurance elsewhere in Dodd-Frank.

A. The Board has the Statutory Authority to Exclude Insurance Subsidiaries.

The plain language of the statute does not require the application of the rules to insurance subsidiaries. The statute applies to "covered financial institutions," defined to include depository institution holding companies, but the statute does not directly apply to insurance subsidiaries of insurance SLHCs.[52] The statute permits but does not require regulators to apply Section 956 restrictions to any other financial institution. Thus, under the plain language of the statute the Board is permitted to exclude insurance subsidiaries of insurance SLHCs.

B. Excluding Insurance Subsidiaries is Consistent with the SEC's Treatment of Broker-Dealer and Investment Adviser Subsidiaries.

Consistent with the plain language of the statute and the discretion afforded to regulators, the SEC excludes subsidiaries of broker-dealers and investment advisers with assets of $1 billion or more.[53] We believe such an exclusion is appropriate for insurance subsidiaries.

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[50] SEC Incentive-based Compensation Arrangements, 17 C.F.R. § 303, 83 (2016).
[51] *Id.*, at 60.
[52] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956.
[53] SEC Incentive-based Compensation Arrangements, 17 C.F.R. § 303, 240, and 275 (2016).

C. Excluding Insurance Subsidiaries Avoids a Statutory Construction Issue.

In addition to being permitted under the statute and consistent with the treatment of investment adviser and broker-dealer subsidiaries, we support the exclusion of insurance subsidiaries because it avoids a statutory construction issue posed by the NPR. The NPR implements Section 956(b) of the Dodd-Frank Act, which imposes prohibitions on compensation arrangements that provide for excessive compensation that could lead to material financial loss to the institution.[54] Additionally, Section 956(d) stipulates that any guidelines and regulations issued pursuant to Section 956 shall be enforced under Section 505 of the Gramm-Leach-Bliley Act ("GLBA") and a violation of Section 956 shall be treated as a violation of subtitle A of title V of such Act.[55]

Section 505 of the GLBA provides that the Board shall have enforcement authority over "bank holding companies and their nonbank subsidiaries or affiliates (except broker, dealers, persons providing insurance, investment companies and investment advisers)."[56] In addition, Section 505 provides for enforcement "[u]nder State insurance law, in the case of any person engaged in providing insurance, by the applicable State insurance authority of the State in which the person is domiciled, subject to section 104 of [GLBA]."[57] At the time the GLBA was enacted, the Board did not have authority over savings and loan holding companies. Furthermore, the GLBA's enforcement mechanism recognizes the need to protect the regulatory regimes of functionally regulated entities, including functionally regulated subsidiary insurance companies.

The Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") acknowledge the GLBA limitation on their enforcement authority against insurance subsidiaries in their definitions of "covered institution." The OCC defines as covered institution as:

> "A subsidiary of a national bank, Federal savings association, or Federal branch of a foreign bank that: "(i) Is not a broker, dealer, ***person providing insurance***, or investment adviser; and (ii) has average total consolidated assets greater than or equal to $1 billion." (emphasis added).[58]

Similarly, the FDIC defines "covered institution" as a subsidiary of a state nonmember bank, state savings association, or a state insured branch of a foreign bank, as such terms are defined in Section 3 of the FDIA,[59] that: "(i) is not a broker, dealer, ***person providing insurance***, or investment adviser; and (ii) has average total consolidated assets greater

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[54] 2016 Proposed Rule, *supra* note 4, at 306.

[55] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956(d).

[56] Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 § 505 (1999) [hereinafter GLBA].

[57] *Id.*

[58] See 2016 Proposed Rule, *supra* note 4, at 60-61 (explaining how the OCC specifically defines "covered institutions").

[59] 12 U.S.C. 1813 (2012).

than or equal to $1 billion." (emphasis added).[60]

The Board defines covered institution to include functionally regulated subsidiaries, including insurance companies.[61] We respectfully suggest that excluding persons providing insurance (insurance subsidiaries) better reflects the authority granted by Section 505 of the GLBA and the intent of Congress.

The Board has broad authority under Section 10(g) of the Home Owners' Loan Act ("HOLA") to issue regulations to protect the safety and soundness of insurance SLHCs.[62] However, Congress was explicit in Section 956 of Dodd-Frank that it was to be enforced under Section 505 of the GLBA. Section 505 of the GLBA does not provide the Board with enforcement authority over persons providing insurance, whether an insurance holding company or insurance subsidiary.[63] This is in apparent tension with the definition of "covered institution" under Section 956, which does include insurance SLHCs.[64] Also, Section 956(e)(2)(G) permits but does not require the regulators to treat other financial companies as "covered financial institutions."[65] This section cannot be read as granting the Board authority to impose the rule on insurance subsidiaries, because it is in conflict with the more specific language in GLBA Section 505 exclusion persons providing insurance.

In our view, given the lack of authority in Section 505 of GBLA over persons providing insurance, the exclusion of insurance subsidiaries of insurance SLHCs from Section 956 is not in doubt. Section 10(b) of HOLA provides the Board with examination authority over functionally regulated subsidiaries, including the authority to ***monitor*** a subsidiary's compliance with Federal laws that the Board has specific jurisdiction to enforce against the company or its subsidiary. However, because the NPR is enforced under Section 505 of the GLBA, and because that Section does not provide the Board enforcement authority over persons providing insurance, the Board would not have authority to enforce Section 956 against insurance subsidiaries under either GLBA or under HOLA.

In fact, the Board has recognized that it does not have enforcement authority under the GLBA for SLHCs and their non-banking subsidiaries. On July 22, 2011, the Board issued a notice of intent and request for comment entitled "Continued Applications of Regulations to Savings and Loan Holding Companies."[66] This notice states the Board "does not expect to enforce [former Office of Thrift Supervision (OTS) regulations found in] parts ... 568, ... 570, 571, ...573. The Board believes that these provisions only apply to the supervision of savings associations and are not applicable to SLHCs or their non-depository

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[60] See 2016 Proposed Rule, *supra* note 4, at 61-62 (explaining how the FDIC specifically defines "covered institutions").
[61] *Id.*, at 57-58.
[62] Home Owner's Loan Act, 12 U.S.C. §§ 1461-1463 (1989).
[63] Gramm-Leach-Bliley Act § 505.
[64] Dodd-Frank Wall Street Reform and Consumer Protection Act § 956(e)(2)(A)-(G).
[65] *Id.*, at § 956(e)(2)(G).
[66] Continued Applications of Reg.'s to Savings and Loan Holding Co.'s , 76 Fed. Reg. 43953 (proposed July 22, 2011).

institutions."[67] The former OTS regulations cited by the Board in the notice are those regulations implementing Title V (Sections 501 to 510) of the GLBA. Therefore, the Board has previously recognized that those sections of GLBA do not apply to SLHCs and the OTS did not have authority to issue and enforce the GLBA against insurance companies that are SLHCs and their non-depository subsidiaries that are persons providing insurance. By indicating that the Board would not enforce these provisions against SLHCs and their non-depository subsidiaries, the Board appropriately recognized that these provisions of the GLBA would be enforced by state departments of insurance for insurance SLHCs and their non-depository insurance subsidiaries.

For the above reasons, we believe that the Board must exclude from its definitions of "covered institution" and "regulated institution" persons providing insurance (insurance subsidiaries of insurance SLHCs), similar to the OCC and the FDIC's definitions of "covered institution."

Conclusion

Congress has consistently indicated its intent that federal regulations should be tailored to the business of insurance, including several places in the Dodd-Frank Act (e.g., the Collins Amendment and its subsequent clarifying amendment as well as the Volcker Rule). While the Section 956 general restrictions on excessive compensation apply to insurance SLHCs, we believe that the Board's statutory obligations are met relative to insurance SLHCs through the application of the 2010 Guidance. We believe that the Board has the authority to and should exclude insurance SLHCs from the final rule. As an alternative, Board has the statutory authority to and should exclude insurance assets from total consolidated assets, and exclude insurance subsidiaries from the rule. Either of our suggested approaches would better reflect the business practices and material risks in insurance SLHCs and would reflect the intent of Congress to tailor federal regulations to insurance.

Thank you for your consideration of our comments. We look forward to a continued dialogue as the rule is finalized.

Sincerely,

Bridget Hagan
Executive Director, The Insurance Coalition

[67] *Id.*