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Via E-Mail to regs.comments@federalreserve.gov

November 30, 2017

Janet Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Re: Large Financial Institution Rating System; Regulations K and L (Docket No. R-1569 RIN 7100-AE82)

Dear Chair Yellen,

On behalf of the American Council of Life Insurers (the "ACLI"),[1] and its 290-member life insurance companies, we are writing in response to the request of the Board of Governors of the Federal Reserve System (the "Board") regarding the proposed rule ("Proposed Rule" or the "Proposal") to apply a new rating system for large financial institutions ("LFIs"). We are pleased to engage in dialogue with the Board and other stakeholders on the development of appropriate ratings standards for LFIs.

Insurance-centric SLHCs Are Properly Excluded from the Proposed Rule

ACLI appreciates the Board's exclusion of insurance-centric Savings and Loan Holding Companies ("ISLHCs") from the Proposed Rule.[2] This exclusion is appropriate in our view given that the Board has not yet finalized capital standards for ISLHCs. In addition, we believe that any rating system that applies to ISLHCs should be tailored to reflect the unique business models of insurers, which the Proposed Rule does not. Although ISLHCs are exempt from the Proposal, the rating system the Board ultimately implements for LFIs could inform any rating system the Board may eventually implement for ISLHCs. As certain ACLI members are ISLHCs, ACLI has an interest in commenting on the Proposal to represent their perspective.

In addition to supporting the Board's decision to exclude ISLHCs from the Proposed Rule, we respectfully recommend that the Board wait to propose a rating system for ISLHCs until the Board finalizes capital standards for ISLHCs. We would also urge the Board to ensure that any rating system that applies to ISLHCs in the future is appropriately tailored to reflect the unique business models of insurers and to account for the existing state regulatory capital framework for insurers. Applying a rating system that has

[1] American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 290-member companies operating in the United States and abroad. 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 the financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at www.acli.com.
[2] Large Financial Institutions Rating System; Regulations K and LL, 82 Fed. Reg. 39049 (Aug. 17, 2017).

been designed for the business of banking—square peg—to the business of insurance—round hole—is not entirely effective, and, if the Board were to design a rating system for ISLHCs, we believe it should be through a separate rulemaking process and designed for the business of insurance.

Further, while the Proposed Rule does not address Systematically Important Financial Institutions (SIFIs) at this time, any related financial ratings rulemaking should also be appropriately tailored to reflect the unique business models of insurers and to account for the existing state regulatory capital framework for insurers.

The New Rating System Should Incorporate a Materiality Threshold for Greater Flexibility

The Proposed Rule seeks to determine whether LFIs are "well managed" or "not well managed" for purposes of certain statutes and regulations applicable to LFIs by assigning a rating to each of three components of an LFI's business: (1) capital planning and positions, (2) liquidity risk management and positions, and (3) governance and controls.[3] LFIs would receive one of four possible ratings for each component: (1) Satisfactory, (2) Satisfactory-Watch, (3) Deficient-1, or (4) Deficient-2.[4] For an LFI to be deemed "well managed," it must receive a Satisfactory or Satisfactory-Watch rating for each of the three components. A single "Deficient-1" or "Deficient-2" rating for any one component would put the LFI at risk of being designated as "not well managed."[5]

ACLI is concerned that the Proposed Rule significantly and inappropriately lowers the threshold for an LFI to be designated as "not well managed." The Board's current rating system for bank holding companies ("BHCs") determines whether a BHC is "well managed" using a 1 to 5 numeric rating scale for certain components and subcomponents of a BHC's business.[6] Under the Proposed Rule, on the other hand, there are only four possible ratings that can be assigned to any one component – two of which (Deficient-1 or Deficient-2), if assigned to any one component, would put an LFI at risk of being designated as "not well managed." Reducing the number of possible ratings for any one component from five to four makes the new rating framework less flexible and less nuanced, thus subjecting LFIs to a more rigid standard. Under the new rating system, LFIs would potentially be more likely to be characterized as "not well managed" – even if they qualify as "well managed" under the current rating system.

This issue is particularly acute for institutions that have a decentralized business model, as is the case for many ISLHCs. Under the proposed new framework, a weakness in any one division or subsidiary that caused the Board to assign a "Deficient-1" rating to just one component could put an entire institution at risk of being classified as "not well managed." The more decentralized an institution's business model is, the more difficult it may be for them to be designated as "well managed." Incorporating a materiality threshold into the rating framework, such that a minor failure in one division would not necessarily compromise an entire institution's rating, would potentially mitigate the impact of this issue. We respectfully urge the Board to consider incorporating materiality thresholds into the LFI rating system to prevent low-level or insignificant failures in any one component from causing the overall firm to be designated as "not well managed" when not otherwise warranted or appropriate.

Thank you for your consideration of these comments, and please contact us should you have any questions.

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[3] Large Financial Institutions Rating System; Regulations K and LL, 82 Fed. Reg. 39050 (Aug. 17, 2017).
[4] Large Financial Institutions Rating System; Regulations K and LL, 82 Fed. Reg. 39051 (Aug. 17, 2017).
[5] *Id.*
[6] *See* Supervision and Regulation Letter 04-18 "Bank Holding Company Rating System," (Dec. 6, 2004), available at: https://www.federalreserve.gov/boarddocs/srletters/2004/sr0418.htm.

Sincerely,

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