September 16, 2016

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

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

Ladies and Gentleman:

New York Life appreciates the opportunity to provide comments on the advance notice of proposed rulemaking (ANPR) issued by the Board of Governors of the Federal Reserve System (the Board) soliciting stakeholder input regarding capital requirements for institutions that are significantly engaged in insurance activities.

Founded in 1845, New York Life is the largest mutual life insurance company in the United States and has the highest possible financial strength ratings currently awarded to any U.S. life insurer from all four of the major credit rating agencies[1]. Headquartered in New York City, our group of companies offers life insurance, retirement income, investments and long-term care insurance. New York Life Investments provides institutional asset management. Other New York Life affiliates provide various securities products and services, as well as retail mutual funds.

We support credible and effective group capital requirements for insurance companies. We have become deeply engaged on the issue of group capital standards at the state, federal and international levels because we expect the standards developed at each of these levels to have a significant impact on our business and the rest of the insurance industry. Although we do not currently own a depository institution, have not been designated systemically important, and are not currently an internationally active insurance group, the proposed federal and international frameworks will likely influence the group capital framework being developed by state regulators and could be regarded by rating agencies as industry best practices.

Furthermore, as a U.S. mutual life insurance company, we bring a valuable perspective to the discussion of group capital requirements. We believe this perspective should be taken into account in the design of group capital requirements at all levels - state, federal and international. The typical U.S. mutual life insurance group has distinguishing structural features, including, for example, greater reliance on the loss absorbing features of participating products and surplus notes, and an organizational form that uses an operating insurer as its ultimate parent. As such, in addition to providing general feedback in this comment letter, we also focus

[1] A.M. Best (A++), Fitch (AAA), Moody's Investors Service (Aaa), Standard & Poor's & (AA+). Source: Individual independent rating agency commentary as of June 9, 2016.

on some of the distinguishing features of U.S. mutual life insurers and the implications for the design of group capital requirements.

Because these proposals outlined in the ANPR do not apply to NYL and we do not have the perspective of the targeted firms, we do not offer any comments on whether or not these approaches are appropriate for the targeted companies. Rather, we offer our perspective on how both approaches could be designed to accomplish broader objectives of sound solvency and competitive insurance markets.

Overall Framework

At the outset, we offer the following broad observations and suggestions for the Board to consider as it further develops the two proposed standards - the building block approach (BBA) and the consolidated approach (CA).

- Tailored for Insurance - We appreciate the Board's efforts to tailor the proposals to the business mix and risk profile of the insurance industry. In particular, we appreciate the Board's recognition that an insurance capital framework should be viewed through a liability-lens and should avoid volatility that does not recognize the stability of traditional insurance liabilities. This tailored approach is critical to ensuring the ability of life insurers to continue offering long duration, guaranteed products and effectively provide financial peace of mind to millions of Americans.

- Transparency & Comparability - As the Board continues its development of capital requirements, those standards should allow for transparency and comparability of insurers' financial strength. An effective capital framework should generate substantially similar results for companies that are similarly situated in terms of business mix and risks, even though they may operate in different jurisdictions, with different corporate structures, and with a different degree of inter-affiliate transaction activity.

- Coordination of Multiple Work Streams on Capital Standards - We appreciate the Board's efforts to coordinate its work on capital standards with similar efforts that are underway at the International Association of Insurance Supervisors (IAIS). Such coordination will help ensure that standards developed at the IAIS are appropriate for U.S. insurance companies and consumers. Further, it is important that the Board continue to work closely with state regulators, the National Association of Insurance Commissioners (NAIC), and the Federal Insurance Office (FIO) to ensure coordination and compatibility of standards being developed at the state, federal and international levels.

  Divergent capital standards have the potential to generate a fractured and unnecessarily complex capital regime for insurers in the United States. While variations may be appropriate to account for differences in size, business mix or systemic importance, these variations should always have a compelling substantive justification. As the details of the Board's proposed capital standards are developed, we believe that appropriate harmonization of the Board's standards with those being developed simultaneously by the NAIC and the IAIS must be a priority.

- Internal Models - In the ANPR, the Board emphasizes that it would like its capital frameworks to be "as standardized as possible, rather than relying on a firm's internal capital models. Greater standardization will produce more consistent capital requirements, enhance comparability across firms, and promote greater transparency."

  New York Life supports the goals of consistency, comparability and transparency. We also believe that the Board is correct to be cautious about the use of internal models. That said, models can provide powerful benefits and have become essential to the business of insurance in the United States. Models serve a particularly important role in the calculation of reserve liabilities that are recorded in financial statements.

  Reliance on internal models simply cannot be avoided in a modern insurance business. They allow more tailored capital calculations that can better accommodate the complex, diverse risks that sophisticated insurers face in today's marketplace. A simple, factor-based approach, unless supplemented with an insurance-appropriate stress testing framework, may not be able to accommodate and capture these complexities and risks.

  We would urge the Board to consider the following:

  - The proposed CA starts with a GAAP balance sheet. The GAAP financial statements of insurers are heavily reliant on internal models. For example, deferred acquisition costs, a major component of GAAP equity, are based on gross margins generated by internal models. Furthermore, loss recognition testing of GAAP reserves is based on internal models.

  - Statutory reserving, a key aspect of BBA, is moving to a principles-based regime that will be driven in large part by internally modeled calculations. Statutory reserves are also validated for asset adequacy using internal models.

  - Risk-based capital uses models in the determination of interest rate risk and various variable annuity risks, among other things.

  We would therefore urge the Board to take model-related risks into consideration as it further develops the BBA and the CA. A key tool for assessing model-related risks is stress testing, as discussed below.

- Stress Testing - As noted above, under either the BBA or CA, model-based output will continue to play a prominent role, as it is inherent in the generation of insurance company financial results. A strong stress testing requirement would recognize this reality and could be designed to capitalize on the strengths of modeling approaches while limiting the potential for arbitrage. It could, for example, be combined with an approach that uses factors to capitalize on the strengths of each system, while minimizing their respective weaknesses.

Building Block Approach

By relying on existing legal entity capital regulation, BBA offers an efficient means of developing a group capital standard that is tailored to the risks of a group's jurisdictions and businesses. Generally, we believe that the Board has identified in the ANPR the appropriate considerations to guide the development of BBA.

To effectively identify problems in a group that could ultimately threaten the company's operations, the BBA must be structured and calibrated properly. Approaches to reserves, asset adequacy, risk-based capital, captive reinsurance and other matters can vary widely, even among U.S. states. The design of adjustments and scalars will need to account for, and keep up with, these differences. As indentified in the ANPR, the objective of comparability will not be achieved if the framework is not appropriately adjusted to "level the playing field".

Ultimately, we believe it is crucial that the capital framework generate substantially similar results for companies that are similarly situated in terms of business mix and risks, even though they may operate in different jurisdictions, and with a different degree of inter-affiliate transaction activity. Adjustments could be mandated to "even out" the effect of the wide range of permitted practices and varying requirements across the states under U.S. Risk Based Capital. Additionally, if other jurisdictions have inconsistencies in solvency application, these must be explored and accounted for to create an equitable approach across companies and reduce the potential impact of regulatory arbitrage both within and across regimes.

Consolidated Approach

Generally, we believe that the Board has identified in the ANPR the appropriate considerations to guide the development of the CA. We would make the following observations and recommendations in relation to the proposed CA:

- Valuation - An important consideration in the design of the CA is the accounting regime used for consolidation. If the consolidated approach is based on U.S. GAAP, it will be important that appropriate adjustments are made to prevent unnecessary volatility in the results. In particular, an appropriate exclusion of Accumulated Other Comprehensive Income (AOCI) would remove unwarranted volatility attributable to short-term movements in assets that back long-dated obligations.

- Assumptions - Somewhat similar to the Asset Adequacy Testing construct under the statutory system, Loss Recognition Testing (LRT) under GAAP requires firms to conduct model-based testing to assess whether reserves should be strengthened.

  In 2014, we published a white paper to suggest a stress testing approach as an international capital construct. As referenced in that white paper within the context of stress testing and in our advocacy around Principles Based Reserving, we offer the following suggestions on the appropriate treatment of assumptions. We continue to believe that actuarial standards of practice regarding the use of assumptions in the LRT construct could include:

  1. Allowance for the use of company-specific assumptions where credible experience exists, accompanied by disclosure, and perhaps verification, of such assumptions.

  2. Prescription of assumptions where company experience and control is limited, such as instances where a policyholder's future actions cannot be predicted, and in matters relating to the future economic environment.

- Treatment of Dividends - A key issue for U.S. mutual companies that offer participating products, such as whole life insurance with the potential for annual dividend payments, is the treatment of such dividends. Specifically, the CA should take into account the essential loss absorbing feature of participating products. Dividends paid on such products are not guaranteed; when faced with increasing financial stress, dividends can be decreased or eliminated entirely.

To appropriately capture such pass-through elements, the Board could consider a lower capital charge for participating products. Alternatively, the Board could also consider a mechanism similar to one presently under development within the Global Insurance Capital Standard (ICS) stream of the IAIS where restatement of liabilities for participating products is available for both stress and factor-based capital charges.

- <u>Surplus Notes</u> - When constructing a possible system for categorizing qualifying capital at U.S. insurers, we encourage the Board to be sensitive to the important role that surplus notes play as a capital resource for U.S. mutual companies. Surplus notes are issuable and payable, as to both principal and interest, only with the prior approval of an insurer's domestic regulator. They are unsecured and subordinated by law to all other creditors of an insurer. These features make surplus notes highly capable of absorbing the losses of a distressed insurer, much like the equity of a stock company. For this reason, statutory accounting treats them as surplus.

  When evaluating whether an instrument can qualify as capital for a group capital construct, the Board should consider whether proceeds can be used to fulfill insurance and non-insurance obligations and whether non-payment triggers an event of default within the group. With surplus notes, proceeds can be used to fulfill insurance and non-insurance obligations and any potential non-payment of surplus notes would not trigger an event of default anywhere within the insurance group. It is our opinion that these features of surplus notes demonstrate the required loss-absorbing capacity.

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In the attached document, we have provided responses to several of the specific questions presented in the ANPR. We appreciate your consideration of our comment letter and look forward to continuing to work closely with the Board on the subsequent notice of proposed rulemaking. Please do not hesitate to contact us if you have any questions or if there is additional information that would be useful.

Sincerely,

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New York Life Responses to Questions Raised in the ANPR

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

We view these considerations as appropriate and also urge the Board to incorporate among its considerations future alignment with group capital developments presently underway at the IAIS and the NAIC.

While differences in standards could be justified by differences in complexity and scope of underlying business, we suggest the Board consider implications of the varying capital regimes on the U.S. insurance market. Firms competing for U.S. premium will include some federally regulated firms, some firms that qualify as state regulated internationally active insurance groups and state regulated firms that operate primarily in the U.S. market. Over the long term, a bifurcated U.S. marketplace could lead to migration of certain activities from one section of the market to the other.

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

As mentioned before, the BBA would use existing capital requirements as a starting point for determining required capital. As such, it appears to be an efficient way to develop a group capital standard that incorporates established legal entity capital requirements that are already tailored to the business of insurance.

However, as the Board further develops the BBA and as the NAIC considers future steps on a group capital calculation, regulators should consider what adjustments to existing capital requirements may be needed to achieve comparability and to minimize opportunities for regulatory arbitrage.

Specifically, a useful BBA will likely need to include adjustments to address differences in the capital regimes across jurisdictions, including:

1. Differences in solvency calculations;
2. Differences in permitted practices; and
3. The impact of intercompany transactions.

These adjustments also will need to be monitored and updated regularly to reflect any future changes to each jurisdiction's underlying capital regimes.

Leveraging the BBA's advantages will ultimately involve accepting some limitations. As explained further in our responses to questions 8 and 9, restatements of state-based variances to the NAIC model, as a general principle, will lead to acceptable levels of comparability of U.S. business. For non-U.S. businesses, appropriate scaling of required capital around levels of regulatory intervention, while accepting differences of valuation and calibration, can lead to an overall BBA ratio that serves regulatory objectives if it is accompanied with a risk-sensitive group-wide stress testing framework.

Question 8: What scalars and adjustments are appropriate to implement the BBA, and make the BBA effective in helping to ensure resiliency of the firm and comparability among firms, while minimizing regulatory burden and incentives and opportunity to evade the requirements?
Question 9: To what extent is the BBA prone to regulatory arbitrage?

For companies primarily operating in the United States, a general principle requiring restatement of reserves and capital to the NAIC model will ensure comparability. In instances where the NAIC has made commendable progress in addressing prospective treatment of known issues, such as the financing of XXX/AXXX transactions, we recommend the Board consider for both in-force and new business the NAIC's proposed solution of modified Principles Based Reserving (PBR), which would need to be backed by high quality assets referred to as Primary Security assets within the NAIC's Actuarial Guidance XLVIII (AG 48). A reduction of reserves from formulaic levels to PBR levels is a departure from NAIC model law and thus departs from our principle of anchoring to the NAIC model. However, if such a departure is accompanied with the requirement to back PBR reserves with higher quality Primary Security assets and if the option for such restatement is made available to all firms that carry such reserves, whether or not the insurance group presently utilizes captives, it will assist with the objective of comparability.

For international entities, to the extent risk charges are not broken down equivalently and provided similar risk charges, some level of arbitrage opportunity will exist. Top-level scaling of an international entity such that its ratio would be identical to, if it were to calculate RBC under NAIC Model Law, would not necessarily eliminate opportunities for arbitrage. If, for example, equities in one jurisdiction receive a heavier charge than the other, over time, the group may be incentivized to move equities towards the lower charge entity creating a lower overall group ratio. We can see that the more complex and/or international a group, the more difficult it will be to address arbitrage opportunities under this approach. However, if done well, the risks of arbitrage may be minimized to a reasonable level.

Question 15: How should the BBA account for international- or state regulator approved variances to accounting rules?
Question 16: What are the challenges in using financial data under different accounting frameworks? What adjustments and/or eliminations should be made to ensure comparability when aggregating to an institution-wide level?
Question 17: What approaches or strategies could the Board use to calibrate the various capital regimes without needing to make adjustments to the underlying accounting?

With respect to variances often formalized as permitted or prescribed practices within the United States, for purposes of the BBA framework, we recommend the Board require a restatement reverting to NAIC model law to ensure comparability. As noted in our response to Questions 8 and 9, we support departing from this principle of model law anchoring in connection with reserving and capital for Term and Universal Life with Secondary Guarantee (ULSG) products where we recommend the use of PBR reserves backed by Primary Security Assets.

An aggregation-based framework like BBA has the benefit of leveraging existing insurance-specific capital frameworks, but this benefit goes hand in hand with the challenges of international differences in accounting. Restatements from market-based valuation regimes to a statutory/book value construct will be too onerous. In lieu of restatement, calibration of required capital could be built around applicable levels of regulatory intervention scaled to an appropriate level of regulatory intervention presently utilized under U.S. RBC.

Question 18: How should the BBA address intercompany transactions?

Affiliate reinsurance transactions involving term and universal life with secondary guarantees ("ULSG") often involve the use of captives and result in significant variances between the results of captive and non-captive user. As noted in our response to Questions 8-9 and 15-17, we recommend adjusting reserving and capital related benefits from captive transactions to reflect the NAIC's proposed solution of modified Principles Based Reserving (PBR), backed by high quality assets referred to as Primary Security assets within AG 48.

Other intercompany transactions that could lead to double counting of capital, such as the down streaming of debt issued at the holding company to provide insurance regulatory capital to downstream entities, should also be appropriately addressed.

Question 20: What are the costs and benefits of a uniform, consolidated definition of qualifying capital in the BBA?
Question 21: If the Board were to adopt a version of the BBA that employs uniform, consolidated definition of qualifying capital, what criteria should the Board consider? What elements should be treated as qualifying capital under the BBA?

We remain unclear on how "uniform, consolidated definition of qualifying capital" should be interpreted. The use of the word "consolidated" typically denotes an accounting construct. Some non-public insurance groups do not prepare GAAP financials and do not consolidate legal entity statutory statements. Because of differences in valuation and reserving, consolidated U.S. GAAP equity will be different from consolidated statutory equity, which will lead to comparability issues.

If we interpret the Board's intent as a uniform set of rules on qualifying instruments applied across the legal entities within the group when calculating group-wide qualifying capital, such an approach could have some merit.

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

An appropriately designed CA could offer some important tools for effective group-wide supervision. First, the CA could align with internal risk management practices at most large companies, as we believe many large insurers manage their capital internally on a consolidated basis. Second, the CA also appears to have the benefit of being potentially compatible with the parameters that the IAIS has established for forthcoming capital standards for internationally active insurance groups. Third, the CA could mitigate potential for arbitrage by imposing consistent treatment across the group and thereby avoiding the possibility of an insurer moving an asset or liability to a jurisdiction with the most favorable solvency treatment. However, volatility of the underlying GAAP assets and non-comparability of GAAP reserves, as explained further in our response to Question 34 below, remain issues that must be appropriately addressed.

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

In developing a definition for qualifying capital under the CA, we recommend a simple threshold test of whether the underlying instrument provides loss absorbing capacity for group-wide activities without triggering default for non-payment.

As stated previously, the Board's standards have the potential to influence the development of other standards internationally and domestically that could apply more broadly. In this regard, when defining qualifying capital, it is important to consider the particular role that surplus notes play in a U.S. mutual company's capital structure. Mutuals cannot issue stock. Surplus notes offer mutuals an important alternative way to raise capital to absorb potential losses. With surplus notes, proceeds can be used to fulfill insurance and non-insurance obligations and any potential non-payment of surplus notes would not trigger an event of default anywhere within the insurance group. Surplus notes are subordinated to policyholders and require regulatory approval prior to any payment. We believe these features of surplus notes demonstrate the required loss-absorbing capacity that should be required of qualifying capital under the CA.

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

We believe the risk segmentation in the proposed Consolidated Financial Statements for Insurance Systemically Important Financial Institutions is an appropriate starting point. In particular, information relevant to Parts A and B - Roll Forwards of Future Policyholder Benefits and Policyholder Account Balances should provide pertinent information on the drivers of changes in underlying liabilities.

By way of reference, in our opinion, the IAIS' ICS effort presently utilizes risk segmentation that is excessively broad. As this process evolves, it will be important to keep the distinct nature of true participating and pass through liabilities in mind, which can vary significantly from fixed cash-flow obligations and other obligations that may be tied to an insurer's portfolio rate but without the features of discretionary pass-through benefits.

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

An enterprise-wide stress testing framework is the most appropriate mechanism to address off-balance risks.

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

GAAP reserves are not generally comparable between firms. Within the context of either the capital or stress testing regime, the Board should consider when it is appropriate for a company to use company-specific assumptions in calculating reserves and when company-specific assumptions may be less appropriate. As an example, it may be appropriate to allow companies to use their own assumptions where credible experience exists, such with respect to mortality. It may, however, be more appropriate for regulators to prescribe assumptions where company experience and control is limited, such as in the selection of macroeconomic assumptions. To achieve the Board's objective of comparability, GAAP reserves will need to be adjusted with appropriate prescription and oversight of assumptions.

On the asset side of the balance sheet, U.S. GAAP reflects mark-to-market valuation. Life insurers typically duration match long-dated liabilities and assets to minimize sensitivity of surplus and better manage their obligations. Further, companies perform liquidity testing and manage assets to be available for the small portion of liabilities which may surrender at any given time. These products are typically accompanied by features such as surrender charges and market value adjustments which disincentivize consumers from surrender in most situations. Internal stress testing and liquidity management is performed to manage these risks. As such, assets held by insurers are not generally subject to "fire sale" possibilities which can sometimes be prevalent in the banking industry. The Board should consider mitigating the volatility of GAAP assets by an appropriate AOCI adjustment for assets that back non-liquid liabilities.

As the Board's views on GAAP adjustments evolve further, we recommend that the framework design ultimately result in assets and liabilities discounted consistently if they are appropriately matched.

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

Life insurers offer products that can be accompanied with high levels of policyholder and management optimality. Certain participating products, such as whole life insurance offered by U.S. mutuals, have non-guaranteed dividends that can be adjusted or eliminated in times of stress upon discretion by the board of directors. Although such dividends are reflected in current GAAP reserves, they don't always reflect the true liability of a company in all economic conditions. In a factor-based regime, the Board should consider a lower charge for liabilities that are truly participating. Within the context of a stress testing regime, or potentially in an eventual move to a stress-based capital framework, the Board could consider allowing restatement of liabilities under stress to reflect the pass-through nature of participating liabilities.

It is also critical that liability-driven nature of the insurance business is reflected in the overall calibration and design, avoiding excessive focus on the asset side of an insurance group's balance sheet.

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

In light of the Board's objectives, the minimum capital ratio should cover both going and gone concerns of the group's insurance and non-insurance obligations. Further, the Board should also consider calibration of overall required capital in conjunction with the desired approaches for stress testing.

With respect to insurance obligations, conservatism in reserves by way of margins, if any, should be considered together with the calibration of required capital. The Board will need to assess whether regulatory objectives are best fulfilled with higher capital in lieu of margins in reserves or vice versa. A certain level of prudence in reserving is desirable while recognizing that excessive prudence in both reserves and capital could lead to unintended consequences.