The Cypress Group

January 22, 2020

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
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Washington, DC 20551
E-mail: regs.comments@federalreserve.gov

Re: Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities

Docket No. R-1673; RIN 7100-AF 56

Dear Ms. Misback:

I write on behalf of The Insurance Coalition (Coalition), a group of insurance companies and other parties with an interest in sound insurance regulation.[1] The Coalition has an interest in federal regulations that apply to insurance savings and loan holding companies (ISLHCs).[2] The Coalition also includes a majority of the ISHLCs that would be subject to the capital standards proposed by the Federal Reserve Board's (Board) Notice of Proposed Rulemaking (NPR)[3] on risk-based capital requirements for depository institution holding companies significantly engaged in insurance activities.

The Coalition greatly appreciates the open and deliberative process conducted by the Board in advance of the release of the NPR. Given the long history of state supervision of insurance companies, and the fact that the Board is developing the first-ever federal capital framework for insurers, a thoughtful process is critical to ensuring that federal rules complement, rather than disrupt, the existing state insurance regulatory system and long-standing industry practices.

The Coalition supports, conceptually, the Building Block Approach (BBA) that is proposed by the Board in the NPR. The BBA is consistent with the Board's continuing focus on adopting a tailored approach to supervision and regulation, which seeks to use

[1] Individual companies that participate in the Coalition may submit their own comment letters on the Notice of Proposed Rulemaking.
[2] An "insurance savings and loan holding company" is defined in the proposed rule to be either a top-tier savings and loan holding company that is an insurance underwriting company, or a top-tier savings and loan holding company that has 25 percent or more of its total consolidated assets in subsidiaries that are insurance underwriting companies. See proposed §217.8.
[3] 84 Fed. Reg. 57240 (Oct. 24, 2019).

the most efficient means to implement a regulatory objective. The Coalition has, however, several recommended revisions to the NPR that would make the BBA more consistent with state insurance regulation and less disruptive for the businesses that have developed under that system.

The balance of this letter is divided into four sections. Section I is an Executive Summary, which provides a general overview of the Coalition's comments. Section II addresses the BBA and explains, in detail, the Coalition's recommended revisions to that capital framework. Section III addresses certain miscellaneous issues related to the NPR. Section IV is a conclusion.

I. Executive Summary

The Coalition supports the BBA as a conceptual framework for ISLHCs. However, as summarized below, we have several recommended revisions to the NPR that would make the BBA more consistent with state insurance regulation and less disruptive for the businesses that have developed under that system. Moreover, before finalizing the rule, we recommend that the Board conduct an analysis of the historical losses and capital levels of insurers in order to calibrate a total capital requirement for ISLHCs that is aligned with the risks of such companies. We also recommend that the Board give ISLHCs sufficient time between the publication of the final rule and its effective date to enable ISLHCs to implement the operational controls and procedure needed to ensure compliance with the rule.

Our major recommended revisions to the BBA are as follows:

- *The Board should reduce the total amount of capital required for an ISLHC and provide that the majority of the total requirement be met by the minimum BBA.* The proposed minimum BBA ratio of 250 percent is higher than the minimum capital required for banking institutions. The proposed percent minimum BBA ratio equates to a banking capital ratio of 8.95 percent. This means that the proposed minimum BBA ratio is approximately 12 percent higher than the required banking capital minimum. This also means that the proposed minimum BBA ratio is 90 percentage points, or more than 55 percent, higher than the 160 percent generated by the Board's scaling methodology. Moreover, the combination of the buffer and the minimum BBA ratio results in a higher total capital requirement for ISLHCs than the Board applies to banking institutions. Currently, the total capital requirement for banking institutions is 10.5 percent, including a 2.5 percent capital conservation buffer. The proposed total capital requirement of 485 percent for ISLHCs, including the capital conservation buffer, translates to a banking capital requirement of 11.4 percent.

- *The Board should consider alternatives to requiring that all in-force reserves be restated in PBR, particularly for companies that do not use captives.* Requiring

such a restatement will impose a significant time and financial burden on ILSHCs without an immediate commensurate level of comparability across supervised firms. Moreover, such a requirement would compel the Board to address several practical issues that traditionally have been addressed by state insurance authorities.

- *The Board should align the limitation on tier 2 capital for ISLHCs with the limitation applicable to banking institutions.* Under the Board's scaling formula, the 62.5 percent limit equates to 0.66 percent, rather than 2 percent (0.625 * 0.0106 RWA). In other words, while tier 2 capital can count for up to 25 percent under the banking capital rules, it can count for no more than 7.4 percent of an ISLHC's BBA minimum requirement.

- *The Board should permit ISLHCs to receive the same credit for additional tier 1 instruments as banking organizations.* The NPR does not give ILSHCs any credit for additional tier 1 capital, yet additional tier 1 capital can count for up to 1.5% of a banking organization's capital requirement.

- *The Board should permit surplus notes to be treated as tier 2 capital without restriction.* We believe that it is entirely consistent with the accounting provision in the 2014 amendment to Section 171 of the Dodd-Frank Act, and congressional intent more broadly, that the Board's final rule reflect the SAP treatment of surplus notes as admitted assets by treating them as tier 2 capital without restriction.

- *The Board should revise the proposed treatment of senior debt.* Specifically, the Board should grandfather existing senior debt held by ISLHCs, and should allow capital credit for senior debt to the extent allowed by the NAIC's Group Capital Calculation (GCC) Working Group. Otherwise, the NPR may have unintended consequences for current and future ISLHCs and discourage publicly traded insurers from being in the business of banking – a result that we do not believe the Board or Congress intended.

- *The Board should reduce the proposed capital charge for title insurance claims.* By treating the claim reserves of title insurers as an asset with a risk-weight of 300 percent, the NPR doubly penalizes the reserve: the reserve is deducted from capital, and then an additional capital charge is imposed on the reserve, using a relatively high risk-weight. This would have the unintended result of inducing companies to lower reserve levels, which is contrary to the Board's mandate to encourage safe and sounding practices.

- *The Board should not require an ISLHC to conduct a separate Section 171 calculation.* Requiring such a separate calculation is not legally required and

would introduce burdens and costs that do not meaningfully advance the Board's supervisory objectives. Because the Board designed the BBA to be "at least as stringent" as the Board's banking capital rule, compliance with the BBA satisfies Section 171.

II. Proposed Revisions to the NPR

A. Before adopting a final rule, the Board should conduct a study of the historical losses and capital levels of insurance institutions, and should monitor implementation of the final rule.

Before adopting a final rule that sets a total capital requirement composed of a minimum BBA and a capital conservation buffer, we recommend that the Board conduct a detailed analysis of historical losses and capital levels of insurance institutions in order to calibrate the requirements with the risk profile of ISLHCs. This analysis can help to ensure that the capital requirements are aligned with the risks posed by ISLHCs.

Additionally, we believe the final rule would benefit from a five-year monitoring period similar to that being employed for development of the International Association of Insurance Supervisors (IAIS) Risk-based Global Insurance Capital Standard (ICS). Similar to the premise for the ICS monitoring period, a monitoring period would enable the Board to assess how the rule is working in practice and to make modifications to resolve material flaws or unintended consequences.

B. The Board should seek public comment on changes in the proposed FR Q-1 reporting form, and should delay the reporting date until June 1st of each year.

Our review of the proposed FR Q-1 reporting form has helped to clarify certain ambiguities in the NPR. Therefore, to ensure complete understanding of the final rule, we believe it would be useful for the Board to seek additional public comment on any changes to the reporting form based upon comments received in response to the NPR.

Additionally, we recommend that the proposed reporting date be moved to June 1st of each year. Currently, every domestic insurer is required to file its RBC reports by March 1st of each year based upon RBC Levels as of the end of the prior calendar year.[4] The proposed March 15th date closely coincides with this annual RBC filing. As a result, the proposed reporting date would place significant demands upon the same operational staff that are preparing the RBC reports. Moving the reporting deadline to June 1st would avoid this compliance burden.

[4] *See* Section 2 of the NAIC's Risk-based Capital (RBC) For Insurers Model Act, January 2012.

C. The effective date for the final rule should give ISLHCs sufficient time to implement the rule, and should be aligned with the year-end NAIC RBC reporting schedule.

The proposed Q-1 report includes an attestation that must be signed by the Chief Financial Officer of an ISLHC. In order to make this attestation, ISLHCs will need to implement appropriate controls and testing procedures. To do this properly will take some time. Therefore, we recommend that the final rule not be effective until at least one year after publication. This would give ISLHCs time to implement the changes needed to make the attestation.

Additionally, as noted above, the current RBC reporting schedule is based upon year-end data. Thus, we further recommend that the effective date of the final rule should be aligned with this year-end schedule in order to ensure that the initial BBA calculation is based upon the most relevant RBC data.

D. The Board should not require ISLHCs to conduct a separate Section 171 calculation.

In conjunction with the establishment of the BBA, the Board is proposing to require ISLHCs to meet a separate minimum risk-based capital requirement that the Board states is necessary to satisfy the terms of Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).[5] As described below, we believe that ISLHCs should not be required to conduct a separate Section 171 calculation, because the BBA's design satisfies the stringency requirements of Section 171.

Section 171 of the Dodd-Frank Act requires the Board to establish minimum risk-based capital requirements, on a consolidated basis, for all depository institution holding companies, including ISLHCs.[6] These capital requirements must be no less than the "generally applicable" capital requirements established by the Federal banking agencies to apply to insured depository institutions (IDIs) under the prompt corrective action (PCA) regulations. Additionally, these capital requirements may not be quantitatively lower than the capital requirements that applied to IDIs when the Dodd-Frank Act was enacted on July 21, 2010. Furthermore, in a 2014 amendment to Section 171, Congress gave the Board the authority to tailor the Section 171 requirement to the business of insurance by excluding insurance assets and liabilities from the minimum risk-based capital calculation.[7]

Based upon these provisions, the Board is proposing that ISLHCs conduct a calculation to determine compliance with the Board's "generally applicable" minimum

[5] Section 171 of Public Law 111-203, Title I § 171, July 21, 2010, codified at 12 U.S.C. § 5371.
[6] In 2010, the generally applicable risk-based capital requirement was the Basel I standard.
[7] P.L. 113-279, 128 Stat 3017 (2014).

risk-based capital requirements.[8] In the case of a top-tier ISLHC that is not an insurance underwriting company, this calculation would apply to the top-tier company. In the case of a top-tier ISLHC that is an insurance underwriting company, the calculation would apply to the farthest upstream savings and loan holding company in the organization that is not an insurance underwriting company (i.e., an "insurance SLHC mid-tier holding company").[9]

The Board also is proposing that a top-tier ISLHC that is not an insurance underwriting company or an insurance SLHC mid-tier holding company may elect not to consolidate the assets and liabilities of its subsidiary insurance companies for purposes of this calculation. This would permit a company to exclude its insurance assets and liabilities from the risk-based capital calculation, consistent with the terms of the 2014 amendment to Section 171. However, if a company makes such an election, the NPR would require the company to either: (1) include a deduction for the amount of the company's outstanding equity interest (and retained earnings) in its subsidiary insurers; or (2) apply a 400 percent risk weight to its outstanding investment (and retained earnings) in its subsidiary insurers.

As described below, Section 171 does not mandate a separate calculation by individual companies. Requiring such a separate calculation is not legally required and would introduce burdens and costs that do not meaningfully advance the Board's supervisory objectives. Because the Board designed the BBA to be "at least as stringent" as the Board's banking capital rule, compliance with the BBA satisfies Section 171. Furthermore, it is not appropriate for any Section 171 calculation to treat ISLHCs differently based upon their organizational structure (i.e., whether the top-tier company is an insurance underwriting company). There is no prudential regulatory basis for such disparate treatment.

Compliance with the BBA should be deemed to constitute compliance with Section 171.

The preamble to the NPR states that under the BBA, the minimum risk-based capital requirements that would apply for purposes of the Section 171 calculation are the same requirements that are applied under the current "generally applicable" capital rules. Therefore, the Board has acknowledged that compliance with the BBA *"ensure[s] compliance with Section 171 of the Dodd-Frank Act."*[10] [Emphasis added]. In other words, the Board, in effect, has concluded that Section 171 would be satisfied by compliance with

[8] The Board's current generally applicable risk-based capital rule requires 4.5 percent common equity tier 1 (CET1) capital, 6 percent total tier 1 capital, and 8 percent total capital.
[9] The NPR defines an "insurance SLHC mid-tier holding company" to mean a savings and loan holding company domiciled in the United States that: (1) is a subsidiary of an insurance savings and loan holding company to which subpart J applies; and (2) is not an insurance underwriting company that is subject to state-law capital requirements. *See* proposed §217.2.
[10] 84 Fed. Reg. at 57246.

the BBA because "the BBA produces results that are not less stringent than the Board's banking capital rule."[11] Therefore, there is no need for companies to undertake individual Section 171 compliance calculations. Instead, the Board should rely upon the fact that the BBA is at least as stringent as the "generally applicable" bank capital rules. This approach has been used by the Board for all depository institution holding companies, other than very large bank holding companies that are required to use the Advanced Approaches capital framework.[12]

A review of the Board's implementation of Section 171 also makes clear that dual computation of capital levels is not required for ISLHCs. As noted above, Section 171 was adopted as part of the 2010 Dodd-Frank Act. Later that same year, the Board, along with the other Federal banking agencies, issued a notice of proposed rulemaking to implement Section 171 by making changes in the risk-based Advanced Approaches regime. In the preamble to that proposed rule, the Board and the other Federal banking agencies explained that they were not asking the banking organizations subject to the Standardized approach to take any steps with respect to Section 171, and that the agencies *themselves* would undertake a quantitative analysis of any proposed amendment to the leverage requirement or to the Standardized approach to ensure that neither rule would require less capital than would be required under Section 171.[13]

In the preamble to the final rule related to the Advanced Approaches regime,[14] the Board and the other Federal banking agencies reiterated that they would use a quantitative analysis (on an aggregate basis) of any future capital framework so that the *agencies themselves* could ensure compliance with Section 171:

> As some commenters noted, comparing capital requirements on an aggregate basis is an effective way of conducting the "quantitatively lower" analysis and the agencies expect to propose this method as appropriate in future rulemakings.
>
> The agencies anticipate performing a quantitative analysis of any new capital framework developed in the future for purposes of ensuring that

[11] *Id.*

[12] While it is not specifically mandated by law, the Advanced Approaches calculation has been implemented by the Board as a means for the nation's very largest bank holding companies to calculate their risk-based capital requirement. The large bank holding companies that use the Advanced Approaches are required to undertake dual capital computations because the Advanced Approaches calculation can result in lower capital requirements than under the generally applicable standardized approach. In order to comply with Section 171, Advanced Approaches companies must calculate capital under both the Advanced Approaches and under the standardized approach, and then comply with the higher requirement. The BBA, unlike the Advanced Approaches, cannot result in lower capital requirements than under the generally applicable standardized approach. Therefore, unlike the Advanced Approaches companies, there is no need for dual capital computations for ISLHCs that are not subject to the Advanced Approaches.

[13] 75 Fed. Reg. at 82320 (Dec. 30, 2010).

[14] 76 Fed. Reg. 37620 (June 28, 2011).

> future changes to the agencies' capital requirements result in minimum capital requirements that are not "quantitatively lower" than the "generally applicable" capital requirements for insured depository institutions in effect as of the date of enactment of the Act. By performing such an analysis, the agencies would ensure that all minimum capital requirements established under section 171 meet this requirement, including minimum requirements that become the new "generally applicable" capital requirements under section 171.[15]

Thus, the Board and the other Federal banking agencies have recognized that compliance with Section 171 does not require individual company capital computations, and that compliance can be determined by the agencies undertaking industry *aggregate* analyses to ensure that any new capital framework would meet Section 171 minimums. In other words, Section 171 requires the Board, not individual companies, to analyze its capital rules and determine that those rules satisfy Section 171.

The Board has recognized its legal authority to apply Section 171 in a flexible manner.

In other rulemakings, the Board has acknowledged that it has flexibility in applying Section 171. In 2011, the Board published a notice that it was "considering applying to SLHCs the same consolidated risk-based and leverage capital requirements as BHCs to the *extent reasonable* and feasible *taking into consideration the unique characteristics of SLHCs* and the requirements of HOLAs."[16] [Emphasis added] Later that same year, when issuing a final regulation implementing Section 171, the Board noted that Section 171 must be read in context with the other provisions of the Dodd-Frank Act to avoid imposing conflicting or inconsistent regulatory capital requirements.[17] In that final Section 171 regulation, the Board also stated that it had the flexibility to assign risk-weights to assets that were not subject to risk-weights under the generally applicable banking rules, notwithstanding that no such authority is explicitly found in Section 171.[18]

Additionally, in 2013, the Board excluded ISLHCs from bank-centric capital requirements otherwise applicable to savings and loan holding companies.[19] The Board took this action notwithstanding the statutory language of Section 171, explaining that it needed to explore further "*whether and how*" the capital rules should be applied to ISLHCs.[20] [Emphasis added] Thus, as of 2013, the Board clearly believed that it had the

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[15] *Id.* at 37622.
[16] Federal Reserve Board, Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, Doc. OP-1416 (April 15, 2011).
[17] 76 Fed. Reg. at 37626.
[18] *Id.*
[19] 78 Fed. Reg. 62018 (October 11, 2013).
[20] *Id.* at 62017. "The Board will explore further *whether and how* the proposed [capital] rule should be modified for these companies in a manner consistent with section 171 of the Dodd-Frank Act and safety and soundness concerns."

flexibility to exempt ISLHCs from Section 171, and proceeded to do so until the current rulemaking.

The legislative history of the 2014 amendment to Section 171 supports the Board's flexibility in applying Section 171.

In 2010, when Section 171 was originally enacted into law, the status of insurance companies subject to the section's requirements was not explicitly addressed. Nevertheless, the author of Section 171, Senator Collins, as well as legal experts, noted that the Board had legal authority to exclude insurance companies from the Section 171 capital requirements.[21] At that time, it also was noted that, because Section 171 did not specifically refer to the business of insurance, the Board lacked clear authority to supersede state insurance capital rules based upon the McCarran-Ferguson Act, which provides that "[N]o act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."[22] In fact, these concerns proved persuasive in 2013 when the Board agreed to study "whether and how" to impose capital standards on ISLHCs.[23]

In 2014, Congress amended Section 171 to provide an explicit clarification that the Board had the flexibility to exclude insurance companies from the minimum bank capital requirements. This amendment originated as S. 2270, sponsored by Senators Collins, Brown and Johanns, and introduced in the Senate on April 29, 2014.[24] Senator Collins reiterated her view that Section 171, as passed in 2010, already provided the Board with the authority to recognize the differences between banking organizations and insurance companies.[25] She explained that S. 2270 was being introduced to resolve any "reservations" that the Board may have about its discretion to recognize the differences between banking and insurance when implementing Section 171. The bill also directed the Board not to require insurers that file statements using SAP to instead prepare statements under generally accepted accounting principles (GAAP).[26]

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[21] *See* "Finding the Right Capital Regulation for Insurers Under the Dodd-Frank Act," Hearings Before the Subcommittee on Financial Institutions and Consumer Protection, Senate Comm. On Banking, Housing and Urban Affairs, 113th Cong. 2d Sess. (March 11, 2014) ("Senate hearings"). For a comprehensive legal analysis, see statement and prepared material of H. Rodgin Cohen, Senior Chairman, Sullivan & Cromwell, Senate hearings at 40.

[22] 15 U.S.C. § 1012. It was argued the Board's capital proposal disregards the state-based regulatory capital and reserving regimes applicable to insurance companies and thus would impair the solvency laws enacted by the states for the purpose of regulating the business of insurance. Some commenters also said that the proposal would alter the risk-management practices and other aspects of the insurance business conducted in accordance with the state laws, also in contravention of the McCarran-Ferguson Act.

[23] 78 Fed. Reg. 62018 (October 11, 2013).

[24] S.2270, 113th Cong.2d Sess. (2014).

[25] 160 Cong. Res. S2471 (April 29, 2014).

[26] *Id.*

The legislative history of the 2014 amendment to Section 171 also makes clear that the carveout for insurance companies is not limited to the insurance company, but also includes affiliates and subsidiaries that are necessary to the business of insurance. On December 10, 2014, days before S.2270 was enacted, Senators Collins, Brown and Johanns, the original sponsors of the legislation, entered into a colloquy about the bill. In this exchange, Senator Johanns explained that the carveout for insurance companies is not limited to the insurance company, but also includes affiliates and subsidiaries that are a necessary adjunct to the business of insurance:

> In determining insurance versus non-insurance activities of a supervised entity, the legislation provides regulators with the flexibility to tailor the rules for certain affiliates or subsidiaries of insurance companies that are necessary to the business of insurance, including, for example, affiliates or subsidiaries that support insurance company general and separate accounts.
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> Our legislation defines "business of insurance" by reference to section 1002 of the Dodd-Frank Act....The reference to this definition of the "business of insurance" will help ensure that insurance activities of federally supervised companies are subject to tailored capital rules, whether those activities are undertaken by the insurance companies themselves or by their affiliates or subsidiaries on their behalf. [27]

In sum, the legislative history of Section 171, and the Board's own prior interpretations of the provision, indicate that the Board has considerable legal authority to apply Section 171 in a manner that recognizes the unique characteristics of ISLHCs.

The Board should apply the small savings and loan holding company exception to ISLHCs.

Section 171 provides, at subsection (b)(5)(c), that the requirements of the Section do not apply to a savings and loan holding company that is subject to the Board's "Small Bank Holding Company and Savings and Loan Holding Company Policy Statement." This policy statement currently is applicable to savings and loan holding companies with consolidated assets of $3 billion or less.[28] Therefore, we urge that the Board consider whether an ISLHC meets the definition of a "small savings and loan holding company" for purposes of Section 171, after excluding all insurance assets within the enterprise. If the remaining assets are equal to or less than $3 billion, the Board can and should exempt the ISLHC from Section 171 requirements, as authorized by that statute.

[27] *Id.* at 6530 (Dec. 10, 2014).
[28] 12 C.F.R. § 225 Appendix C, made applicable to savings and loan holding companies at 12 C.F.R. § 238.9.

A Section 171 calculation should not vary based upon the organizational structure of an ISLHC.

The application of the separate Section 171 calculation is also inappropriate because it applies differently to different ISLHCs solely based upon their organizational structures. Under the NPR, a top-tier savings and loan holding company that is not an insurance underwriting company would be subject to the Section 171 calculation, and, if the company elects not to consolidate its assets and liabilities for purposes of the calculation, it would be required to either deduct its equity investment in subsidiary insurance companies, or risk-weight that investment at 400 percent. In contrast, a top-tier savings and loan holding company that is an insurance underwriting company would not be subject to a separate Section 171 calculation. For such companies, the Section 171 calculation would be imposed upon an insurance ISLHC mid-tier holding company that is not an insurance underwriting company within the organization.

There is no prudential regulatory rationale for imposing different capital requirements on top-tier holding companies simply because of variations in corporate structure. For example, a top-tier holding company that is an insurance underwriting company would not be required to deduct or apply punitive risk-weights to its equity investments in subsidiary insurance companies. On the other hand, if the same company decided to place a shell holding company as its top-tier parent, the equity deduction or 400 percent risk-weight would apply.[29] Yet, both companies are economically equivalent. They both hold insurance assets. However, because of the equity deduction or 400 percent risk-weight, one company would be subject to a higher amount of required capital than the other company.

The Board has recognized that the imposition of the equity deduction or 400 percent risk-weight could yield inaccurate or overly conservative results for the Section 171 calculation.[30] In the NPR, the Board explained that such overly conservative results would be obtained if the top-tier holding company has issued debt to fund equity contributions to the insurance subsidiaries.[31]

These problems can be avoided simply by eliminating any requirement for an ISLHC to conduct a separate Section 171 calculation. As we have noted above, the BBA satisfies the Section 171 requirement, and, thus, there is no need for the Board to require a separate Section 171 calculation, which would have differing impacts on different ISLHCs because of their organizational structure. In sum, unless the Board eliminates the separate Section 171 calculation, the rule will have unintended consequences for the governance structures of ISLHCs and will create opportunities for regulatory arbitrage based solely on the organizational structure of an ISLHC.

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[29] Consider, for example, the case of a mutual insurance company that reorganizes by converting to stock form.
[30] 84 Fed. Reg. 57247 (Oct. 24, 2019).
[31] *Id.*

We oppose the proposed equity deduction method.

In Questions 3 and 4 in the NPR, the Board requests comment on the two alternative methods for making the proposed separate Section 171 calculation when a company does not consolidate its assets and liabilities for purposes of the capital calculation: the equity deduction method, and the equity risk-weighting method. As noted above, we believe *strongly* that a separate Section 171 calculation is not required by statute, and that Congress specifically sought to avoid the imposition of bank capital standards on insurance companies.

We also have significant concerns with the Proposal regarding the equity deduction method. We believe that deducting the holding company's equity investment in insurance subsidiaries would be unduly punitive. An equity deduction equates to a 1250 risk weight. Moreover, in response to Question 5 in the NPR regarding the appropriate risk-weighting of investments in subsidiary insurers, we believe that such risk-weights should track the NAIC RBC treatment of equity investments in affiliates.

E. <u>We support an adjustment to the transitional measures regarding in-force reserves</u>.

Question 24 in the Proposal invites comments on proposed adjustments to capital requirements, and also asks what other adjustments the Board should consider. We request that the Board clarify the scope of the proposed adjustments. The NPR states that an ISLHC must remove the effect of "any" transitional measures in the BBA calculation. This broad statement could inadvertently capture transitional measures the Federal Reserve does not intend to be included in the adjustment. For example, the Current Expected Credit Losses framework is effective for SEC filers beginning January 1, 2020, but the effective date is delayed for private and certain small public companies until January 1, 2023. Even after the effective date, companies may elect a three-year transitional period whereby the regulatory capital effects of the update to the accounting standard are phased in over a three-year period. Further, insurance regulators will often provide transition periods with respect to new mortality tables, as those mortality tables impact reserving and financial reporting, but also product design and pricing. We recommend that the Board clarify in the final rule that the adjustment for transitional measures applies only to XXX/AXXX reserving.

We also are concerned about the impact of immediately restating covered in-force business in accordance with the NAIC's principles-based reserving (PBR) methodology.[32]

[32] In order to address overly conservative reserving requirements imposed by the NAIC's XXX and AXXX reserving methodologies, the NAIC adopted the PBR methodology for new business policies sold after the date a company adopted it (as early as January 1, 2017, and no later than January 1, 2020). The PBR does not apply to a business in force before that time.

We appreciate the Board's desire to achieve comparability across all insurance firms under its jurisdiction. However, we believe that requiring that all in-force reserves be restated in PBR, particularly for companies that do not use captives, involves a significant time and financial burden without an immediate commensurate level of comparability across supervised firms. It is also important to note that since no new business will be sold using AXXX/XXX reserves, its impact on insurers' finances will decline with time.

Additionally, this requirement would compel the Board to address several practical issues. For example, could an ISHLC restate pre-2017 reserves using the 2017 NAIC Commissioners Standard Ordinary (CSO) table, which the NAIC intends to use going forward? Addressing this and other practical compliance issues could require detailed guidance from the Board and would cause the Board to encroach on supervisory matters that have traditionally been reserved for state insurance authorities.[33]

In order to minimize the compliance burden on ISLHCs (as well as the Board), and to maximize regulatory efficiency, we offer the following alternatives as options to the reserving methodology required under the NPR. In considering these alternatives, it is worth recognizing that the effect of applying PBR to pre-PBR level term life insurance and universal life insurance policies with secondary guarantees (ULSG) is likely to be a reduction in liabilities and a corresponding increase in available capital. So, while alternatives that provide supervised firms with the option not to apply PBR (or an approximation of PBR) to pre-PBR business may reduce comparability of results across supervised firms, such alternative will produce more conservative results for the firms making such elections.

First, we propose that ISHLCs currently using, or that elect to use, GAAP for the establishment of their life insurance and other mortality benefit reserves be permitted to use GAAP reserves (net of Deferred Acquisition Costs (DAC)) for purposes of approximating a PBR-level reserve for pre-PBR level term business under the BBA, and that ISHLCs that do not use permitted and prescribed practices be allowed to utilize SAP in their current basis of presentation. We propose this as a one-time election.

Alternatively, the Board could employ one of the approaches the NAIC is considering to estimate PBR results for its Group Capital Calculation (GCC). This

[33] The "Fed-Lite" functional regulation provisions of the Gramm-Leach-Bliley Act. *See* 12 U.S.C. §§1831v, 18310-1 1844(c) and (g). These provisions effectively limit the Board's authority to use the assets of a state regulated insurance subsidiary as a source of strength for the IDI, and prohibit the Board from imposing any capital rule, guideline, standard or requirement on a state regulated insurance subsidiary that is in compliance with state imposed capital requirements. Since the overwhelming portion of the assets of the companies that currently would be subject to this rule are housed in insurance entities, the application of capital standards at the holding company level may, as a practical matter, directly impact the capital framework of subsidiary insurance companies. This might be viewed as inconsistent with the "Fed-lite" functional regulation provisions.

approach would greatly simplify the restatement to PBR while maximizing regulatory efficiency and alignment with state practices.

Finally, as another option the Board could exclude companies that have *de minimis* current and future exposure to life insurance products from its proposed PBR requirements. Specifically, where life insurance products represent an immaterial portion of a company's overall business, and the company no longer sells new life insurance policies (and has no plans to do so in the future), we believe the required application of PBR methodologies to the company's in-force life insurance policies would be particularly inappropriate. We would urge the Board to permit such companies to refrain from applying a retroactive PBR valuation methodology to their life insurance products.

F. Scaling Methodology, Minimum Capital Requirement, Capital Conservation Buffer, Tier 2 Capital, and Additional Tier 1 Capital

We support the proposed scaling methodology because it ensures compliance with Section 171.

In order to calculate a company's BBA ratio, the Board is proposing a scaling methodology that translates banking capital rules into an amount of the NAIC's RBC regime. The scaling formula for the denominator in the BBA ratio (required capital) equates a company's total risk weighted assets (as calculated under the banking capital rules) with the NAIC's Authorized Control Level (ACL) RBC for insurers. The scaling formula for the numerator in the BBA ratio (available capital) equates a company's tier 1 and tier 2 capital (as calculated under bank capital rules) with the NAIC's Total Adjusted Capital (TAC). This translation ensures that the requirements of Section 171 are met through the design of the BBA, with no additional calculation needed.

We support this scaling methodology. As explained in the White Paper accompanying the proposed rule,[34] the scaling formulas are based upon probability of default rates for banks and insurers derived from reliable data sets maintained by banking and insurance regulators (i.e., Call Reports and NAIC's Global Insurance Receivership Information Database). Additionally, the data sets span economic cycles;[35] are based upon comparable definitions of default;[36] use a three-year time horizon for defaults in order to balance an interest in observing a reasonable number of defaults beyond the most weakly capitalized companies and an interest in maximizing the number of data points that

[34] Comparing Capital Requirements in Different Regulatory Frameworks, September 2019 (the "White Paper").
[35] The data covers a 17-year period from 1998 to 2015.
[36] An insurer was considered to be in default if it fell below the minimum capital requirement and (1) had its license suspended in any state, (2) was acquired, or (3) discontinued underwriting new businesses. A banking organization was considered to be in default if it was significantly undercapitalized (total capitalization below 6 percent of RWA) and did not recover.

could be used in the regression analysis; and have been filtered to exclude anomalous inputs (e.g., small firms were excluded).

Moreover, in selecting this scaling methodology the Board took into consideration three factors: the reasonableness of assumptions; the ease of implementation; and the stability of parametrization. Reasonable assumptions include those that are reflective of supervisory experience, and that allow the Board "to better assess the safety and soundness of institutions and ultimately to better mitigate unsafe or unsound conditions."[37] Ease of implementation refers to the ease with which the scaling formula can be derived based upon available data. The stability of parametrization refers to the extent to which changes in assumptions or data affect the value of the scaling formula.

The sum of the minimum BBA ratio and the capital conservation buffer is overly conservative.

The Board has proposed a minimum BBA ratio of 250 percent. The Board has explained that this minimum ratio is based upon the combination of two factors. First, using the proposed scaling methodology, the Board translated the minimum total capital requirement of 8 percent of risk-weighted assets under the Board's banking capital rule to its equivalent under NAIC RBC. Second, the Board added a "margin of safety" to the minimum in order "to account for factors including any potential data or model parameter uncertainty in determining scaling parameters and an adequate degree of confidence in the stringency of the requirement."[38] As a result, the 250 percent minimum "aligns with the midpoint" between the NAIC's CAL RBC requirement and the NAIC's TTL RBC requirement.[39]

While we support the scaling methodology as ensuring compliance with Section 171 without further calculations, a minimum BBA ratio of 250 percent is higher than the minimum capital required for banking institutions. Under the terms of the Dodd-Frank Act, the Board has a statutory obligation to ensure that the minimum BBA is not less than the "generally applicable" capital requirements for IDIs and not quantitatively lower than the capital requirements applied to IDIs on July 21, 2010.[40] To meet this statutory standard, the minimum BBA ratio must translate to no less than a minimum total capital requirement of 8 percent. As the chart below indicates, basic algebraic calculations demonstrate that an 8 percent ratio equates to a minimum BBA of 160 percent, and that the proposed 250 percent minimum BBA ratio equates to a banking capital ratio of 8.95 percent. This means that the proposed minimum BBA ratio is approximately 12 percent higher than the required banking capital minimum. This also means that the proposed

[37] White Paper, p. 6.
[38] 84 Fed. Reg. 57261 (Oct. 24, 2019).
[39] *Id.*
[40] Section 171 of the Dodd-Frank Act.

minimum BBA ratio is 90 percentage points, or more than 55 percent, higher than the 160 percent generated by the Board's scaling methodology.

Capital Elements	**Insurance Requirement**		**Banking capital Requirement**
	BBA	***Calibration***	
Initial Min. Assessment	160%	8%[41]	
Minimum Requirement	250%	8.95%	8%
Buffer Requirement	235%	2.5%	2.5%
Total Requirement	485%	11.4%	10.5%
Qualifying Capital Limits			
Tier 2 Limit/ Risk Weighted Assets (RWA)	0.66%[42]		2.0%
Additional Tier 1 (AT1) Limit/ RWA			1.5%
Tier 2 / Min. Req.	7.4%		25.0%
(AT1 + Tier 2) / Min. Req.	7.4%		43.75%
AT1 / Min. Req.	N/A		18.75%[43]

The Board justifies this additional amount of capital in order to address uncertainty in the data and models used in the scaling methodology. We believe, however, that the data and models used in the scaling methodology are relatively free of uncertainty. The data sets used in the scaling formulas are reliable, long-term data sets maintained by federal and state financial regulatory authorities that have been filtered to exclude anomalous data. Moreover, as noted above, the Board took into consideration factors designed to enhance the reliability of the methodology in designing the scaling methodology.

In addition to the overly conservative minimum requirement, the Board has proposed a capital conservation buffer of 235 percent under the NAIC RBC framework. This buffer is intended to be equivalent to the 2.5 percent capital conservation applicable under the banking capital rules. We have several concerns with this proposed buffer.[44]

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[41] $(Add)_2 \frac{T1+T2-0.063*RWA}{0.0106*RWA}$

[42] $(Add)_{sum} = 0.625 * 0.0106\ RWA$

[43] Assumes the bank has 2% tier 2.

[44] In addition to the concerns listed in the body of the letter, we note that, for purposes of the buffer, the NPR defines capital distributions to include discretionary dividends on participating insurance policies because, for mutual insurance companies, these payment are equivalent to stock dividends. This treatment is not consistent with the treatment of these payments under state insurance rules. Accordingly, we recommend that such payments not be considered as the equivalent of a return of capital in the final rule.

First, as noted above, the proposed minimum BBA more than satisfies the Section 171 requirement. Second, the proposed percentage for the buffer is based upon the 2.5 percent capital conservation buffer established for banking institutions. However, the buffer for banking institutions was based upon a calibration of the loss experience of U.S. banking institutions and their historical capital levels, not the loss experiences and capital levels of insurance institutions.[45] Third, the Board's desire to align the buffer for ISLHCs with the buffer applicable to banking institutions is not appropriate under the principles of administrative law.[46]

Finally, as the above chart indicates, the combination of the buffer and the minimum BBA ratio results in a higher total capital requirement for ISLHCs than the Board applies to banking institutions. Currently, the total capital requirement for banking institutions is 10.5 percent, including a 2.5 percent capital conservation buffer. The proposed total capital requirement of 485 percent for ISLHCs, including the capital conservation buffer, translates to a banking capital requirement of 11.4 percent. Additionally, for banks, the capital conservation buffer of 2.5 percent represents about 30 percent of their minimum capital requirement of 8 percent, whereas the proposed buffer of 235 percent for ISLHCs represents 94 percent of the minimum required BBA ratio of 250 percent.

In sum, the NPR would impose a materially greater minimum capital requirement on ISHLCs than on standardized approach bank holding companies that do not engage in significant insurance activities. The conservatism inherent in the margin of safety is unnecessary because the scaling mechanism is based on a rigorous historical analysis. Additionally, the over-conservatism would impose a higher cost of capital on insurance firms that are, or may seek to be in the future, affiliated with insured depository institutions. This could discourage affiliations between insurance firms and insured depository institutions, and it would be contrary to the policy set by Congress in 1999 with the enactment of the Gramm-Leach-Bliley Act (GLBA),[47] which permits such affiliations under a holding company structure supervised by the Board. The Act was passed to facilitate the financial integration of financial services for the benefit of consumers and businesses, under a functional regulatory framework. As the "umbrella"

[45] 78 Fed. Reg. 62034 (Oct. 11, 2013).
[46] Under the Administrative Procedure Act, the Board is required to issue regulations based on a consideration of all "relevant factors," that is the factors set out by Congress. Neither of the laws upon which the NPR is based requires that the capital standards for ISHLCs be comparable to those applicable to banking organizations. The buffer is not required by Section 171 of the Dodd-Frank Act, and Section 171 specifically recognizes the differences between the banking and insurance industries by authorizing the Board to exclude insurance companies when determining compliance with the Section. Section 10(g) of the Home Owners' Loan Act requires that the capital standards for savings and loan holding companies be "appropriate" and "counter-cyclical;" it does not require that such standards be comparable to banking capital rules.
[47] P.L. 106-102.

regulator for such firms, the Board has a statutory obligation to support, rather than discourage, such affiliations.

To address this over-conservatism, we recommend that the Board reduce the total amount of capital required for an ISHLC, and provide that the majority of the requirement be met by the minimum BBA. For example, the Board could set a total capital requirement of 395 percent for an ISHLC, which is composed of a minimum BBA of 250 percent, and a capital conservation buffer of 145 percent. This approach would ensure compliance with Section 171, provide the "margin of safety" sought by the Board, and address our concerns with the current proposal.

Additionally, as we noted at the outset of this letter, before adopting a final rule that sets a total capital requirement composed of a minimum BBA and a capital conservation buffer, we recommend that the Board conduct a detailed analysis of historical losses and capital levels of insurance institutions in order to calibrate the requirements with the risk profile of ISLHCs.

G. The limitation on tier 2 capital should be aligned with banking capital requirements.

The Board has proposed that tier 2 capital instruments, as defined in Regulation Q, may not count for more than 62.5 percent of a top-tier parent's building block capital requirement. This limitation is intended to ensure that an ISLHC's capital has sufficient loss absorbing capability. It also is intended to align with banking capital rules. In the preamble to the NPR, the Board states that:

> The firm's tier 2 capital, held in the amount of 62.5 percent of the top-tier parent's building block capital requirement, would be one-fourth of available capital at the minimum requirement under the Board's banking capital rule, corresponding to 2 percent of risk-weighted assets in the context of the Board's banking capital rule.[48]

Yet, the Board's scaling methodology indicates that the tier 2 limitation does not align with banking capital rules. Under the Board's scaling formula, the 62.5 percent limit equates to 0.66 percent, rather than 2 percent (0.625 * 0.0106 RWA). In other words, while tier 2 capital can count for up to 25 percent under the banking capital rules, it can count for no more than 7.4 percent of an ISLHC's BBA minimum requirement.

We have calculated the combined effects of the NPR's standards of 250% minimum capital requirement, 235% additional capital conservation buffer, and the 62.5% tier 2 limit as applied to the hypothetical insurance holding firm with tier 1 Capital of $7.5 billion, tier 2/Surplus Notes capital of $1 billion, and total consolidated risk-weighted

[48] 84 Fed. Reg. 57260, n. 75 (Oct. 24, 2019).

assets of $35 billion. This calculation illustrates that such an ISLHC would have to hold more than $800 million more in tier 1 regulatory capital under the BBA than under the banking capital rules – an outcome that we believe is not appropriate or intended.

This disparity is not justifiable on policy grounds. To address this disparity, we recommend that the Board permit ISLHCs to hold the same amount of tier 2 capital as banking organizations. Specifically, we recommend a tier 2 limit of *211%* of the "building block capital requirement" (as defined in § 217.607 of the NPR). This recommendation is based on assuming minimum BBA ratio of 250% which equates to 8.95% of risk-weighted assets under the banking capital rules. Recognizing the 25% Tier 2 banking limit implies a Tier 2 limit of 25% * 8.95% = 2.238% of risk-weighted assets. Scaling back to terms of BBA required capital results in a limit of *211%* = 2.238% / 0.0106.

H. ISLHCs should receive credit for additional tier 1 instruments.

The NPR does not provide a separate category of capital corresponding to additional tier 1 instruments. The Board has explained that this limitation is based upon its supervisory experience, which indicates that insurers do not commonly use capital instruments that meet the criteria for additional tier 1 capital, and that when such instruments are used they do not represent a material proportion of the insurer's capital.[49] In comparison, additional tier 1 capital can count for up to 1.5% of a banking organization's capital requirement.

We believe that ISLHCs should receive the same credit for additional tier 1 instruments as banking organizations. Specifically, we recommend an Additional Tier 1 limit of *158%* of the "building block capital requirement" (as defined in § 217.607 of the NPR). This recommendation is based on assuming minimum BBA ratio of 250% which equates to 8.95% of risk-weighted assets under the banking capital rules. Recognizing the 18.75% Additional Tier 1 banking limit implies a limit of 18.75% * 8.95% = 1.678% of risk-weighted assets. Scaling back to terms of BBA required capital results in a limit of *158%* = 1.678% / 0.0106.

While such instruments have not been commonly used by insurers, the rule should accommodate the use of such instruments in the future. In other words, the rule should be sufficiently flexible to accommodate changes in marketplace practices and conditions. Otherwise, the rule could lead to unintended competitive disparities between ISLHCs and banking organizations.

We further recommend that any capital requirements, including minimum ratios and limitations on qualifying capital, be phased in over a two-year transition period beginning on January 1, 2021. Moreover, to the extent the Board requires any total amount above 395%, such amounts should be phased in over a longer timeframe, with each

[49] *Id.*, n. 76.

increase (or decrease) being subject to a similar approval mechanism as the countercyclical capital buffer.

I. Surplus notes should be treated as qualifying capital instruments without limitation.

In Questions 28 and 29 in the NPR, the Board seeks input on the treatment of surplus notes. The treatment of surplus notes for purposes of the BBA in the NPR is drawn from the analogous treatment of tier 2 instruments in the Basel banking rules. We do not believe that this is required by statute and propose that surplus notes be treated as qualifying capital instruments without limitation.

The 2014 amendment in Section 171 included a provision that prohibited the Board from requiring ISLHCs from recalculating financial statements according to GAAP, and instead deferring to statutory accounting principles (SAP) under state laws.[50] While the 2014 statutory provision was specific to the accounting treatment for non-public insurance companies, it reflected a broader concern that such companies not be treated either like GAAP-filers or like bank holding companies by the Board's capital rule.

We believe that it is entirely consistent with the accounting provision in the 2014 law and congressional intent more broadly that the Board's final rule reflect the SAP treatment of surplus notes as admitted assets by treating them as tier 2 capital without restriction. This is particularly appropriate because non-public insurance companies that issue surplus notes also rely on SAP – a population that Congress specifically sought to protect in the 2014 provision addressing accounting.

In addition to reflecting congressional intent, we believe that deferring to the state treatment of surplus notes is sound from a public policy perspective. Insurance companies that are not publicly held do not have access to the equity markets, and the treatment of surplus notes in the NPR for non-grandfathered surplus notes would make their issuance less attractive, which we believe is not what the Board intended.

Additionally, by restricting non-grandfathered surplus notes in terms of treatment as available capital, and by limiting tier 2 capital instruments to 62.5 % of an ISLHC's "building block capital requirement," the NPR would effectively create tiers of capital. We are concerned that, for those ISLHCs for which surplus notes are the only "non-organic" way of raising capital, the NPR's limited recognition of surplus notes makes it more difficult for such firms to meet the capital conservation buffer requirement. We would suggest that surplus notes be included as available capital for purposes of meeting the capital conservation buffer requirements.

[50] P.L. 113-279.

J. The treatment of senior debt should be revised.

Under the NPR, senior debt issued by an ISLHC would not be qualifying capital for purposes of the BBA because it would not be subordinated to general creditors of the ISLHCs. Moreover, the NPR would require an ISLHC building block parent to deduct any investments in its subsidiary building block parent capital instruments from its own available capital. Consequently, a non-operating ISLHC that raised senior debt would not be able to recognize the benefit of the senior debt to its subsidiary insurance underwriting companies under the BBA.

We believe that this proposed treatment of senior debt may have unintended consequences for current and future ISLHCs and discourage publicly traded insurers from being in the business of banking – a result that we don't believe the Board or Congress intended. Additionally, the Board is not subject to statutory constraints that require identical treatment between bank holding companies under Regulation Q's minimum capital requirements and ISLHCs under the BBA – indeed, Congress intended that the Board tailor rules for ISLHCs that explicitly incorporate the state insurance regulatory system.

Given the potential disruption for certain ISLHCs and the potential to discourage future ISLHCs, we believe that the Board should provide for the following treatment of senior debt. First, the Board should grandfather the senior debt of ISLHCs. Second, the Board should allow capital credit for senior debt to the extent allowed by the NAIC's Group Capital Calculation (GCC) Working Group. That working group is actively considering the treatment of senior debt issued by a non-insurance holding company. That working group has recognized that "it may be appropriate to develop criteria within the [working group] that permit some amount of subordinated senior debt to be added back to capital."[51] The NAIC also has submitted a comment letter to the Board in connection with this NPR indicating a concern that requiring the holding company to deduct senior debt used to capitalize the insurance entity could have an adverse impact on policyholders.[52] Such an approach will avoid the potential for conflict between the Board's final rule and the NAIC's GCC, which is important both domestically and internationally.

Additionally, in the event that the Board determines that the finalized GCC's treatment of senior debt did not substantively fulfill the stringency standards of the risk-based capital requirements of Section 171 of the Dodd-Frank Act, we propose that the deduction for a top-tier building block parent's investments in the capital instruments of a subsidiary building block holding company whose applicable capital framework is NAIC RBC be reduced by the lesser of: (1) the amount of senior debt issued by the top-tier

[51] Memorandum to Group Capital Calculation Working Group from David Altmaier, Chair, on the Treatment of Senior Debt and Surplus Notes in the Group Capital Calculation, Oct. 7, 2019.
[52] NAIC Comment Letter to the Board dated Dec. 12, 2019.

building block parent that meets the criteria for "qualifying capital instruments" other than prong (ii) of the definition (regarding subordination); and (2) the "building block capital requirement" for the ISLHC attributable to insurance building blocks (including the capital conservation buffer). Also, with regard to state-regulated title insurance that have a building block capital requirement set under banking rules, we believe an economically equivalent approach to this proposal is warranted. Finally, we recommend that the final rule include a reasonable transition period.

K. Treatment of title insurance claim reserves and title plant.

The NPR provides that an ISLHC that is primarily engaged in title insurance must use a modified version of the Board's banking capital rules.[53] Specifically, the NPR would place a 300 percent risk weight on claim reserves related to the title insurance policies issued by the ISHLC. The proposed 300 percent risk-weight on title insurance claims reserves is inappropriately high, which discourages reserving, and the Board has not provided a sufficient basis for the proposed risk-weight.

The NPR, by treating the claim reserves of title insurers like an asset with a risk-weight of 300 percent, disincentivizes the creation and maintenance of this type of reserve in two ways: the reserve is deducted from capital, and then an additional capital charge is imposed on the reserve, using a relatively high risk-weight. This would have the unintended effect of inducing companies to lower reserve levels, which is contrary to the Board's mandate to encourage safe and sound practices.

It also is contrary to the treatment the Board applies to loss reserves held by banks. The Board has recognized that bank loss reserves act as a financial buffer. Thus, the bank loss reserve is included as a component of a bank's tier 2 capital up to 1.25 percent of total risk-weighted assets in the Basel III Standardized Approach.[54] Furthermore, for capital purposes, a bank is not required to hold capital against the remainder of the loss reserve that is not a component of Tier 2 capital.[55] Unlike the NPR's treatment of title insurance claim reserves, for banks a robust loss reserve is encouraged by: (1) allowing a portion of the reserve to be included in Tier 2 capital; and (2) not imposing a capital charge on the remainder of the loss reserve. The proposed treatment of title insurance is the direct opposite. Rather than recognizing and supporting the establishment of a title claim loss reserve, the NPR would establish a punitive 300% risk-weight for these reserves.

Additionally, the NPR does not provide the basis for its conclusion that the level of insurance claim reserves is an appropriate measure of the risks inherent in a title insurance business. The NPR also does not describe why the Board concluded that title claim reserves are comparable to assets assigned a 300 percent risk-weight, and we respectfully suggest that this risk weight is inappropriately high and that title claim

[53] 84 Fed. Reg. at 57250.
[54] *Id.*
[55] *See, e.g.*, 12 C.F.R. § 3.2.

reserves are not analogous to any assets subject to a 300 percent risk weight in the banking capital regime.

Furthermore, significant changes in both mortgage and title insurance underwriting standards and practices since the Great Recession have taken place. Many of these changes have been driven by regulations passed in the Great Recession's aftermath. These changes have had the effect of lowering the volatility associated with title claim loss reserves.

If the Board retains a capital charge based on claim reserves, it should not be risk weighted at 300 percent. The 300 percent risk weight is the risk weight generally applied to publicly traded equity securities. However, the volatility associated with title claim reserves is more aligned with (and still lower than) the volatility of high-yield corporate bonds. Therefore, we believe that a more reasonable risk-weight for title claim reserves would be the same as that applicable to the 100 percent risk weight applicable to high-yield corporate bonds.

A second issue pertaining to the unique status of title insurance companies under the NPR is the treatment of core title plant assets. The NPR would specifically exclude title plant assets from the capital calculation. We believe that title plant assets should be included in the calculation at a risk weight of 100 percent. Title plants are essential assets for title insurance companies and title agents. They are a readily transferable asset, with many potential purchasers. They are carried on the balance sheet at the cost of acquiring or building the plant, which is typically less than a current fair market value. They are admissible assets under SAP and are viewed by investors and analysts as part of the title company's tangible book value.

III. Miscellaneous Issues

A. <u>The market-adjusted valuation approach is not appropriate for U.S insurers</u>.

In Question 1 in the NPR, the Board requests comment on the market-adjusted valuation approach (MAV) for the ICS under development by the IAIS. We believe strongly that the MAV is an inappropriate way to address capital adequacy and penalizes U.S. products and companies through its treatment of long-duration insurance liabilities.

In Question 2 in the NPR, the Board seeks comment on an aggregation approach as a viable alternative to the ICS. We strongly support an aggregation approach as an alternative to the ICS. This is particularly important given the primacy of the U.S. insurance market globally. In assessing comparability, we support examining whether an aggregation method is sufficiently stringent to ensure solvency of regulated entities under normal and stress economic scenarios, rather than a method that is focused on quantitative outcome equivalence. Any determination of quantitative outcome equivalence based on the current version of the ICS would unfairly penalize U.S. policyholders and insurers. The ICS was designed for and by countries with a much more

robust government role in social insurance and thus for companies that do not provide capital-intensive products with long-tail liabilities.

B. We support the application of the BBA to bank holding companies significantly engaged in insurance activities.

In the NPR, the Board notes that the final rule will address the application of the BBA to bank holding companies significantly engaged in insurance activities. We support the application of the BBA to such companies. Application of the BBA to bank holding companies significantly engaged in insurance activities will ensure harmonization with the treatment of ISLHCs and avoid the potential for regulatory arbitrage.

C. The final rule should include a materiality threshold in determining inventory companies.

To identify inventory companies, the Board is proposing to use a combination of NAIC's schedule Y (prepared in accordance with the NAIC's SSAP No. 25), Board forms FR Y-6 and FR Y-10. The NPR also includes a mechanism to include entities not captured on the above forms. We appreciate the Board's thoroughness in capturing all possible inventory companies but believe this requirement to be a highly significant undertaking without a commensurate benefit to the Board's supervisory objectives. This is particularly true because of the investment activities of insurance companies, including through general account assets. We believe that the final rule should include a materiality threshold to ensure that the definition of inventory companies does not sweep in arrangements that support investment activities but do not represent operating companies or materially contribute to an ISLHC's risk profile.

D. The final rule should not require audited financial statements where no audit requirement currently applies.

Section 605(b)(5) of the NPR, titled "Financial Statements," would require a supervised insurance organization to prepare financial statements in accordance with SAP with respect to any inventory company whose applicable capital framework is NAIC RBC. Section 605(b) is not clear, however, on the nature of the financial statements required for building block parents whose applicable capital framework is the banking capital rules or any other inventory company, including whether those financial statements need to be prepared in accordance with GAAP and whether they would need to be audited.

If interpreted broadly, this Section could be read to require audited financial statements from all inventory companies in an ISLHC's corporate structure. Such a requirement would be extremely burdensome, without offering a proportional supervisory benefit. We request that the Board clarify that Section 605 does not impose a standalone requirement for audited financial statements where none previously existed.

E. The final rule should clarify the treatment of all SEC- and CFTC-regulated subsidiaries.

We generally support the BBA's method of determining applicable capital frameworks but believe that the final rule should include a clarification regarding the treatment of all Securities and Exchange Commission (SEC) and Commodities Futures Trading Commission (CFTC) regulated subsidiaries. We understand the NPR to indicate that such subsidiaries are subject to capital rules that are not considered to be "scalable" and therefore would be subject to the capital framework of their building block parent. However, the NPR also notes that investment advisers are ineligible to be treated as material financial entities and thus subject to federal banking capital rules.

We support clarification in the final rule that financial subsidiaries, as defined under Section 121 of the Gramm-Leach-Bliley Act (GLBA), should be subject to banking capital rules if they are subsidiaries of a bank, and subject to the NAIC RBC rules of the upstream parent, if they are subsidiaries of an insurance company. We also support asset management entities that are neither subsidiaries of a bank nor an insurance company being treated to NAIC RBC rules for BBA purposes, because they are not dependent on the bank for their safety and soundness. To treat non-bank-controlled asset managers under banking rules simply because they are not owned by an insurance affiliate vaults form over substance, inviting confusion and inefficient internal restructuring.

F. The NPR should be harmonized with the Board's recent revisions to common stock repurchases.

We recommend that the NPR be harmonized to the Board's July 2019 revisions to its regulatory capital rules to clarify that prior Board approval of common stock repurchases is not required for common stock to qualify as "qualifying capital" absent a separate prior approval requirement.[56] This change would promote regulatory efficiency, eliminating the burden and cost of applications to the Board.

G. Definition of an "insurance savings and loan holding company."

The definition of "insurance savings and loan holding company" set forth in the NPR should be clarified to respect the fact that not all top-tier potential ISLHCs are required to prepare consolidated financial statements. The NPR defines an "insurance

[56] Notably, Regulation Q's definition of common equity tier 1 capital was amended to provide in relevant part that..." (iii) The instrument... can only be redeemed via discretionary repurchases with the prior approval of the Board *to the extent otherwise required by law or regulation* ..." 12 C.F.R. §217.20(b)(iii). (emphasis added). This clarification from July 2019, embodied by the italicized words cited above, appears to have been inadvertently omitted from the equivalent reference in the NPR: i.e., proposed Section 217.608(a)(vi). Thus, we would propose clarification to revise proposed Section 217.608(a)(vi) to read in its entirety as follows: "(vi) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the Board to the extent otherwise required by law or regulation."

savings and loan holding company" as "(1) a top-tier savings and loan holding company that is an insurance underwriting company; or (2)(i) a top-tier savings and loan holding company that, as of June 30 of the previous calendar year, held 25 percent or more of its total consolidated assets in subsidiaries that are insurance underwriting companies (other than assets associated with insurance underwriting for credit risk). . ."[57] The second part of this definition assumes that a top-tier ISLHC prepares consolidated financial statements and can use them to demonstrate that 25 percent or more of its total consolidated assets are in insurance underwriting company subsidiaries. Without clarification, this definition could be interpreted as requiring the preparation of financial statements in accordance with GAAP by an insurance company in violation of the prohibition Congress imposed on the Board in 12 U.S.C. 5371(c)(3)(A), which prohibits imposing such a requirement under authority of Section 171 or HOLA. We believe that the Board did not intend such an interpretation of the definition.

To address this issue, we suggest that the Board utilize the approach it took in Section 246.3(a)(2)(ii) of Regulation TT.[58] Specifically, we urge the Board to allow a top-tier ISLHC to calculate an estimate of its total consolidated assets and the assets of its insurance underwriting subsidiaries to demonstrate that it satisfies the "25 percent or more" standard of the "insurance savings and loan holding company" definition. Such a clarification could be added as a footnote to subsection 2(i) of the definition of "insurance savings and loan holding company" and simply state: "If a savings and loan holding company does not prepare consolidated statements, such company shall use the estimation approach authorized by Section 246.3(a)(2)(ii) of Regulation TT to estimate its total consolidated assets and investment in insurance underwriting company subsidiaries for purposes of demonstrating that it satisfies this '25 percent or more' requirement."

IV. Conclusion

The Coalition appreciates the opportunity to submit this comment letter. If you have any questions regarding the matters addressed in the letter, please contact me at 571-212-2036 or bridget@cypressgroupdc.com.

Sincerely,

Bridget Hagan
Executive Director
The Insurance Coalition

[57] *Id.* at 57275.
[58] 12 CFR § 246.3(a)(2)(ii).