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January 22, 2020

Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Subject: Comments on Notice of Proposed Rulemaking on Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities (Docket No. R-1673 and RIN 7100-AF 56)

VIA EMAIL to regs.comments@federalreserve.gov

Dear Ms. Misback:

We appreciate the opportunity to provide comments on the Notice of Proposed Rulemaking (Proposed Rule) regarding risk-based capital requirements for insurance depository institution holding companies (IDIHCs). Please find our responses to the Board's specific questions in the **Appendix** to this letter.

We strongly support the current state-based system of insurance regulation, including use of the National Association of Insurance Commissioners (NAIC) Risk-based Capital (RBC) framework for evaluating insurer capital adequacy. We note that NAIC RBC is a time-tested, effective framework that has been in place for decades and has operated through a variety of business cycles, extreme market conditions, and extraordinary catastrophic events. We support efforts to develop frameworks to assess capital adequacy on an enterprise basis and believe an aggregation-based approach that fully leverages existing, effective, jurisdictional capital adequacy frameworks such as NAIC RBC will produce the most efficient and effective outcomes. While we generally support the construction of the aggregation-based building block approach (BBA) in the Proposed Rule, we have certain concerns including instances where the BBA overrides the judgments of state insurance regulators including where the BBA eliminates the impact of regulator-approved permitted and prescribed practices.

While acknowledging the Board's objective of maintaining consistency in capital adequacy computations across IDIHCs, we do not believe reasoned judgments of state insurance regulators designed to address limitations with existing statutory rules should be overridden in any proposed enterprise capital framework. We believe the judgement of state insurance regulators should be given primacy as a fundamental rule; this is especially critical when considering times of extreme stress or crisis where the application of state insurance regulator judgment to address limitations should not be

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overridden by non-insurance regulators as this would be extremely destabilizing to the insurance industry and the broader financial markets.

Overall, while we support the objective of the Proposed Rule, we believe the Board should consider revising certain aspects of the BBA as outlined in the attached **Appendix** to make the proposed framework an aggregation-based approach that effectively captures the material risks of an IDIHC and allows regulators to address them in a timely manner.

If you have any questions, do not hesitate to contact us.

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Appendix

Question 1: Comparative strengths and weaknesses of the IAIS market-adjusted valuation (MAV) approach and the Building Block Approach (BBA)

The principal strength of the BBA, as compared to the MAV-based insurance capital standard (ICS), is that, as an aggregation-based framework, the BBA leverages the existing time-tested and highly effective NAIC RBC framework which was specifically developed to complement the unique characteristics of the U.S. insurance market, including the manner in which insurers are capitalized, managed, and regulated and the variety of insurance contracts they issue to meet the unique needs of U.S. policyholders. Moreover, U.S. insurance entities are already preparing NAIC RBC submissions which contain much of the data required for the aggregation-based BBA.

In contrast to the NAIC RBC framework, the MAV-based ICS framework would negatively impact the U.S. insurance industry, especially as it relates to long-duration products such as annuities that fill a critical need for customers who need access to stable fixed income products to fulfill their retirement income needs. By its construction the MAV-based ICS would increase the cost of capital needed to support long-term products and they would make them both more expensive and less readily available in the marketplace. In addition, the MAV-based ICS will negatively impact the ability of U.S. insurers to bring the new products to market that are necessary to fulfill the growing and changing needs of insurance consumers. Currently, insurers work with local jurisdictional regulators to ensure a product design meets the needs of policyholders and is supported by appropriate reserving and capital requirements. Upon introduction of the MAV-based ICS, which is subject to the oversight and control of the IAIS, product innovation at the local jurisdictional level will become extremely challenging as products will have to be designed to meet the needs of jurisdictional (e.g., U.S.) policyholders and the potentially incompatible requirements of the MAV-based ICS framework in comparison to NAIC RBC. The result could be that the products are not introduced in a timely manner, not at all, or on a non-economic basis.

Question 2: Aggregation-based approach compared to ICS, including (1) how the aggregation-based approach is a viable alternative to the ICS; and (2) criteria for determining that an aggregation-based approach is outcome equivalent to the ICS

We strongly believe an aggregation-based framework such as the BBA set forth in the Proposed Rule is a viable alternative to the MAV-based ICS. More specifically, the BBA components are time-tested and effective and were specifically designed to meet the needs of the largest, most sophisticated insurance market in the world; i.e., the U.S. market. Moreover, as we have previously stated to the Board, we do not believe it is necessary, or advisable, to have a single global enterprise-based capital framework. Aggregation-based approaches are inherently more efficient and effective as they reflect the jurisdictional differences that make each insurance market unique. Further, when considered collectively, aggregation-based approaches provide the most effective global surveillance mechanism to identify emerging risks on a global basis that affect insurers, and with prompt identification proactive actions may be undertaken.

Concerning comparability between the aggregation-based BBA approach and the MAV-based ICS approach, we do not believe a granular quantitative comparison between the two is necessary.

Currently, the IAIS has disclosed[1] that the principles and criteria to determine comparability will consider "individual elements of a group solvency approach, i.e., valuation, capital resources, and capital requirement." One example of a criterion for comparison should be "aggregation-based method defines capital resources, and the capital resources are classified as capital by a jurisdictional regulator." This proposed criterion would not have a threshold of how much of a certain type of capital can be held but rather focus on the jurisdictional regulator judgment in determining that an instrument meets the criteria to be considered capital. We believe this is critical as it allows disparate legal and cultural environments to determine what qualifies as capital as opposed to a single group far removed from the local jurisdiction and unaware of the unique laws and customs of the jurisdiction.

Question 13: Advantages/ disadvantages and burden associated with the proposed approach to determine capital frameworks

An advantage of the proposed approach for determining capital frameworks is that it respects the fundamental differences between the risks inherent in different types of insurance such as life insurance and property and casualty (P&C) insurance which includes auto and homeowners insurance and the different risks inherent in these products on a jurisdictional basis. The aggregation-based BBA framework leverages the underlying elements of the NAIC's life and P&C RBC frameworks to produce capital requirements that are appropriately tailored to the risks inherent in the underlying contracts or business activity under evaluation.

Question 14: What other definitions of materiality, if any, should the Board consider for use in the BBA?

We believe that if an asset threshold remains in the final rule for the BBA, the Board should increase the 1% threshold for top-tier total assets. Regardless of the materiality threshold, however, all entities within an evaluated enterprise would still be captured in the BBA regardless of whether they are determined to be building block parents. Notwithstanding, we believe a 1% threshold for the building block parent determination could create multiple building block parents and add to the operational complexity and inefficiency of the BBA.

We suggest that if the Board keeps an asset threshold in the final rule, the definition of "material" in 12 CFR 217.602 should be revised to no less than 5% of top-tier total assets.

Question 18: Approaches to address risks presented by asset managers in an insurance depository institution holding company's enterprise

One way the Board could address the treatment of applicable capital frameworks for asset managers is to design a process that allows an IDIHC to more effectively identify risks associated with the activities of an asset manager, regardless of whether the asset manager is registered under the Investment Advisers Act of 1940.

We believe the IDIHC should first identify the applicable capital framework for an asset manager based on the activities of the asset manager. For example, an asset manager created to serve the needs of

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[1] Section 7 of "Explanatory note on the Insurance Capital Standard (ICS) and Comparability Assessment" at https://iaisweb.org/page/supervisory-material/insurance-capital-standard

an affiliated insurance entity (e.g., by advising, managing, and directing investment activities for the insurance entity) would likely have a low risk.

In contrast, asset managers within an IDIHC that primarily serve retail and institutional investors would be subject to different risks, such as the risk of mismanagement or negligence as it relates to customer assets. Further, asset managers could be subject to liquidity risk if the asset manager does not maintain sufficient liquidity to meet its obligations to customers. The Board appears to acknowledge in Supplementary Information section 3(a) that measuring an investment adviser's capital position "using the Board's banking capital rules may not provide a complete depiction of the subsidiaries' risk." We concur with the Board's view that the use of bank capital rules may not align with the risks of the asset manager.

We request that the Board revises the following:

(1) Approach for determining applicable capital frameworks to allow for IDIHCs to apply NAIC RBC rules to asset managers primarily serving affiliate insurance entities;
(2) Guidance for intermediaries to allow an IDIHC to map assets and liabilities of the asset manager to an insurance entity if the asset manager is primarily serving affiliate insurance entities; and
(3) Consider an approach to calculate required capital for asset managers based on the US GAAP liabilities of the asset manager. The Board should subject the proposed approach to a robust feedback process that considers views of the insurance industry, including the operational burden of the proposed approach.

Question 20: Other criteria for building block parents

We do not support the criterion related to a building block parent being "engaged in activities such that one or more inventory companies are expected to absorb more than 50 percent of its expected losses." Depending on the activities of each entity, it could be operationally burdensome to perform a calculation of expected losses.

Question 23: How should the Board develop scalars for international insurance capital frameworks if needed?

We believe the Board should develop a more comprehensive approach to address scalars for international insurance capital frameworks and the proposed approach should be subject to a public comment period similar to the BBA. By not developing a permanent approach for scalars for international insurance capital frameworks, the Board is not allowing IDIHCs to fully evaluate how current or future international insurance operations may be affected by the BBA's capital requirements.

Question 25: Comments on proposed adjustments to available capital

We do not support the following proposed adjustments to capital requirements and available capital:

(1) Elimination of transitional measures and grandfathering in applicable capital frameworks
(2) Permitted and prescribed practices

We considered the purpose of transitional measures and grandfathering and permitted and prescribed practices, including the impact of the measures and practices on an insurance entity's processes and capital management. Transitional measures in applicable capital frameworks allow entities subject to the framework to ease the implementation burden of new or updated guidance because of the significant effort involved in applying the new guidance to existing transactions. Permitted and prescribed practices are the result of an evaluation process undertaken by state regulators where the ultimate judgments are supported by dialogue with affected insurance entities to fully understand all material implications of the proposed deviation from NAIC mandated accounting and reporting practices.

The Board's proposed approach to eliminating the impact of permitted and prescribed practices effectively supersedes the authority of state-based insurance regulators and fundamentally changes the accounting and financial reporting approved by state regulators. We believe the Board should not override the judgments of state insurance regulators and the NAIC regarding permitted and prescribed practices. In the event of a financial crisis, insurance entities must have the flexibility to work with their state-based insurance regulators to ensure the insurance entity maintains sufficient capital that meets the regulator's requirements. Allowing the Board to override the judgments of state insurance regulators will not allow those regulators to work with their regulated insurance entities and "manage through the next crisis". We believe this would be a very unfortunate outcome of the Proposed Rule if implemented in its current form and would be very destabilizing to both the insurance market and the broader financial markets in the event of a financial crisis.

We recommend that the Board deletes the following proposed clauses in the Proposed Rule:

(1) 12 CFR 217.607(b)(3) and 12 CFR 217.608(c)(4) on transitional measures/ grandfathering in applicable capital frameworks
(2) 12 CFR 217.607(b)(2) and 12 CFR 217.608(c)(3) on permitted and prescribed practices

Question 26: Other criteria for determining available capital under the BBA?

One additional point for consideration by the Board is clarification of the language in Proposed Rule 12 CFR 217.608(a)(2)(ii). If tier 1 capital must be classified as equity under U.S. GAAP, it is unclear if there will be a process to reassess the impact of any revised accounting guidance that impacts equity classification. We suggest the Board establish a formal process to review the impact of revised accounting guidance on equity classification and determine whether that revised guidance aligns with the nature of the capital instrument in determining available capital.

Question 27: Proposed criteria for capital instruments with call features is to obtain prior Board approval before exercising the call option. Should the Board apply a de minimis threshold below which this approval is not needed?

We believe a de minimis threshold would be appropriate and the threshold should include consideration of other features of the capital instruments. For example, the Board acknowledges a scenario in footnote 2 of the Proposed Rule in 12 CFR 217.60(v)(C) where a building block parent replaces qualifying capital instruments concurrent with the redemption of existing qualifying capital instruments. If an entity is refinancing a higher cost debt instrument and replacing it with a similar debt instrument with the only changes being the interest rate and a new maturity date, the capital structure of the entity is not fundamentally changing. The institution would still hold an amount of capital commensurate with its risk. We believe that this is one scenario that could be viewed as de minimis where Board approval should not be required.

Question 34: Considerations for the BBA reporting cycle

One consideration for the BBA reporting cycle that is unclear in the Proposed Rule is the process for the Board's discretion to require more frequent reporting discussed in Section X of the Supplementary Information. While there are triggers for more frequent reporting, we believe the triggers are not sufficiently defined and objective and could lead to inconsistent application, as both triggers are based on "significant" changes. Further, it is unclear what information will be used to make the determination for more frequent reporting and who will provide that information. If a supervised company is expected to provide additional data more frequently than annually, those requirements should be clarified so that supervised companies can determine the impact to their processes.

The process for evaluating whether there is more frequent reporting should be interactive, where the Board and the potentially affected company discuss the reasons for more frequent reporting and the data used to arrive at that conclusion. The Board should consider a mechanism that allows an affected company to remedy the situation with the Board before immediately requiring more frequent reporting.

In response to the above points, we suggest the Board refines and provides further details on its proposed process for more frequent BBA reporting. For the triggers, we believe that the Board should (1) define a clear quantitative threshold that determines what is a "significant" change in the most recent reported amounts on proposed Form FR Q-1; and (2) remove the trigger for more frequent reporting based on qualitative attributes, as it will be difficult to consistently assess changes in risk management objectives / policies and nature of reporting systems.

Question 35: Should additional information submitted to the Board pursuant to the BBA be made public?

We do not support the Board's proposed requirement to disclose the top-tier parent BBA ratio and building block available capital and capital requirements. The objective of the Proposed Rule is to create "a consolidated capital requirement that considers all material risks on an enterprise-wide basis" and that the Board "support[s] meaningful public disclosure." We believe public disclosure of the top-tier parent BBA ratio and building block available capital and capital requirements is unnecessary as it was never intended that the aggregation-based BBA would replace NAIC RBC or other independent frameworks (e.g., AM Best) that are traditionally relied upon by policyholders. We suggest that the Board removes the proposed requirement to publicly disclose the top-tier parent BBA ratio, building block available capital and capital requirements.