January 22, 2020

Via Electronic Delivery

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue NW
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 and RIN 7100 AF 56

Dear Ms. Misback:

New York Life appreciates the opportunity to comment on the Federal Reserve's Notice of Proposed Rulemaking (NPR) on capital requirements for depository institution holding companies that are significantly engaged in insurance activities.

Founded in 1845, New York Life is the largest mutual life insurance company in the United States and has the highest possible financial strength ratings currently awarded to any U.S. life insurer from all four of the major credit rating agencies[1]. As a mutual insurer, we have no shareholders. Instead, we operate for the benefit of our policy owners. Headquartered in New York City, our group of companies offers life insurance, retirement income, investments and long-term care insurance. New York Life Investments provides institutional asset management. Other New York Life affiliates provide various securities products and services, as well as retail mutual funds.

We support credible and effective group capital requirements for insurance companies and over the past several years, we have been engaged on this issue at the state, federal and international levels. Although we do not currently own a depository institution, have not been designated systemically important, and are not currently an internationally active insurance group, the Board's proposed Building Blocks Approach (BBA) and the IAIS' Insurance Capital Standard (ICS) will likely influence the outcome of the group capital framework being developed by state regulators, the Group Capital Calculation (GCC). Moreover, any one of these capital frameworks could be regarded by rating agencies as industry best practices or benchmarks.

Our comments are written with the above implications in mind. We focus on four main areas, some of which are more relevant to mutuals and others that impact the entire industry. They are: (1) Adjustments for Permitted and Prescribed Accounting Practices Under State Laws; (2) Adjustments for Transitional Measures in Applicable Capital Frameworks; (3) Criteria for

[1] Fitch Ratings – Rating of AAA (Highest) affirmed December 18, 2019; A.M. Best – Rating of A++ (Highest) affirmed July 24, 2019; Standard & Poor's – Rating of AA+ (Highest for a U.S. life insurer) affirmed December 18, 2019; Moody's Investors Service – Rating of Aaa (Highest), affirmed December 18, 2019.

Qualifying Capital Instruments (Surplus Notes); and (4) Capital Requirements for Asset Managers.

I. Adjustments for Permitted and Prescribed Accounting Practices Under State Laws

The BBA methodology includes a series of adjustments on top of the capital requirements derived under the "Building Block" approach. Sections VI.B.1 and VII.B.3 of the explanatory text in the NPR, together with § 217.607(b)(2) and 217.608(c)(3) of the proposed rule, include adjustments to reverse out permitted and prescribed practices. We support the Board's approach.

When an individual state approves a permitted practice, the result is that the relevant insurer's capital requirement or amount of available capital will deviate from the NAIC's uniform rules. While we agree that some of these practices may have been suitable, over time they have grown in number. The cumulative effect is the creation of discrepancies in financial statements among insurers – including not only those operating in different jurisdictions due to differing regulatory practices and interpretations, but even among those operating in the same jurisdiction. Without adjustments, these discrepancies would impact the effectiveness of the BBA, as they decrease comparability, consistency, and make it more difficult for regulators to assess the financial health of the company.

Another related issue that often takes the form of a permitted practice is the use of letters of credit or other like instruments as permissible assets to back insurance liabilities. These assets are often used in the financing of captive insurer reserves (which are subject to their own adjustment and discussed in Section II of this letter). We believe that the intent of the BBA methodology is to disqualify this category of assets, either because the assets are utilized due to a permitted practice or because they constitute a transitional measure. We support this outcome and would urge that the Board further clarify the standard for valuing these assets in the BBA methodology.

The BBA methodology suggests that insurers should apply the asset valuation standards set forth in the statutory accounting principles (SAP) as contained in the *NAIC Accounting Practices and Procedures Manual.* For XXX and AXXX reserves, that asset valuation standard has been superseded for new business by the more stringent "Primary Security" definition set forth in Actuarial Guideline 48 (AG48) and the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (the XXX/AXXX Model).

Both AG48 and the XXX/AXXX Model grandfathered the asset valuation standard applicable to business issued prior to January 1, 2015 or ceded, as of December 31, 2014, pursuant to certain reinsurance treaties with affiliated captive life insurers. For new policies issued subsequent to that date, they applied a more stringent definition that excluded SAP admissible assets operating in a manner similar to a letter of credit. While we interpret the Board's proposal to mean that the grandfathered policies would have to use the new standard, we would encourage the Board to add clarifying language by indicating that the BBA methodology similarly excludes "any synthetic letter of credit, contingent note, credit-linked note that operates in a manner similar to a letter of credit, and . . . any securities issued by the ceding insurer or any of its affiliates." This would ensure that all companies have a consistent implementation of the asset valuation and provides a strong, robust solvency standard that the NAIC has endorsed for uniform use nationwide.

II. Adjustments for Transitional Measures in Applicable Capital Frameworks

Sections VI.B.3 and VII.B.4 of the explanatory text of the NPR, together with § 217.607(b)(3) and 217.608(c)(4) of the proposed rule, require that the effects of any grandfathering or transitional measures be reversed. The BBA methodology recognizes the conceptual similarity between this adjustment and the adjustment for permitted and prescribed practices, and notes that together they should increase comparability across firms.

In Section I, we describe one possible transitional measure relating to the valuation of assets that support XXX/AXXX liabilities. There is also a corresponding transitional measure relating to the valuation of those liabilities – specifically, the grandfathering of the existing reserve requirement for in-force XXX/AXXX business under the new Principles Based Reserving (PBR) standard adopted by the states. As we read the BBA methodology, in-force XXX/AXXX business would need to be restated on a PBR basis to remove the effect of grandfathering.

We agree, in spirit, with this approach. PBR recognizes that the statutory reserve requirements for XXX/AXXX reserves were too conservative; it seeks to fix the reserve levels and to also address the related incentive for insurers to create captive refinancing arrangements to restate their reserves to "economic" levels. For firms that chose to not pursue these financing arrangements, the statutory reserve levels cause capital to be tied up in these reserves, misrepresenting their capital positions. For there to be a consistent view of these reserves across firms, we agree that an adjustment needs to be made. However, restating in-force reserves to current PBR standards would be impractical.

There are simplified ways to approximate PBR level reserves. One solution that would achieve comparability without fully restating reserves to PBR levels would be to apply a factor-based approach similar to what was tested in the recent NAIC Field Testing of the GCC. For example, utilizing uniform factors for XXX and AXXX reserves would both eliminate the excess conservatism of statutory reserves and achieve approximate PBR levels on in-force business.[2] A factor-based approach also is transparent, easy to administer, and would not require companies to use significant time and financial resources to build out additional modeling capabilities. This latter point is important because, as in-force business matures, the amount of business subject to transitional measures will decrease and this adjustment will become less critical to comparability.

While the factors have not been finalized by the NAIC, we believe that it would be appropriate for the Board and the NAIC to apply a common set of factors to approximate the reduction from statutory reserve levels to PBR levels. Moreover, we believe that regardless of what is determined to be the "correct" factor, the application of the same factors by all firms will result in a restatement that should be comparable and consistent. Some insurers may recommend approaches that lead to alternative bases or methodologies for proxying PBR reserves. However, we would advise against such an approach because these bases rely on internal

[2] In 2018, the NAIC field tested factors of 90% for AXXX reserves and 40% for XXX reserves.

assumptions or provide too much discretion to individual firms. They may be useful for non-statutory reporting or measuring the economic value of a business, but they cannot be relied upon for solvency comparisons. However, the Board could consider input from these alternative bases to calibrate the factor based approach.

III. Criteria for Qualifying Capital Instruments (Surplus Notes)

As a mutual insurance company, surplus notes are important to our business model. We have no shareholders and are not publicly traded, which means that we cannot issue equity to raise additional capital. Instead, the primary way for a mutual to raise capital is using surplus notes, which are treated as surplus (equity) under U.S. Statutory Accounting.

These instruments are unsecured, can only be issued or paid with the prior approval of state regulators, and are subordinated by law to all other creditors. State regulators have considerable oversight over the management of surplus notes, from their issuance all the way to whether to suspend payments. The decision to suspend payments is left to the discretion of the relevant state regulator, whether because of insolvency or the anticipation of insolvency or other financial difficulty.

When regulators disapprove a payment, the non-payment is not considered a default, since it is initiated by the regulator. Insurers are required by law to exclude regulatory disapproval of payments from the definition of default under the terms and conditions of surplus notes. For this reason, surplus note payments are loss absorbent like equity. Regulators can turn off payments anytime to safeguard the payment of the primary liability, the insurance products themselves.

We were therefore surprised to observe that the BBA proposal differs from the current insurance regulatory regime in the following ways:

1. Application of Regulation Q – § 217.608(a) of the proposed rule would impose the Board's requirements in Regulation Q on future issuances of surplus notes by insurers subject to the BBA methodology.
2. Quantitative Caps – § 217.608(d) of the proposed rule would cap the inclusion of surplus notes as available capital at 62.5% of the capital requirement. § 217.604 of the proposed rule includes a minimum capital ratio of 250% and a threshold of 235% for a total of 485%. As described in Section VIII.B of the explanatory text, surplus notes (Tier 2 capital), would not be allowed at all in the threshold of 235%.

We will discuss each item in turn, beginning with the requirement that future issuances of surplus notes meet the Board's requirements as set forth in Regulation Q. That regulation includes specific requirements relating to call options, repurchases and redemptions, including Board approval, that are not part of U.S. Statutory Accounting, are not included in our existing surplus notes, and to our knowledge, are not common features of issuances by other mutual insurers. Investors in surplus notes are accustomed to these instruments and their provisions as they are currently offered. If this requirement is retained in the final BBA methodology, and that methodology is applied at some point in the future to us and other mutual insurers, then we could face pressure to change the common provisions of surplus notes, potentially resulting in disruption of the market and alteration of pricing for these instruments. This outcome, if it were to occur, could inhibit our ability to raise capital.

Furthermore, the proposed synchronization with Regulation Q deviates from the requirements set forth in the NAIC's GCC. The NAIC's GCC does not impose new requirements on surplus notes that deviate from U.S. Statutory Accounting, avoiding potentially adverse consequences to the marketplace.

Although we prefer to eliminate synchronization with Regulation Q, if this feature remains, we are also concerned about the scenario in which an insurer is outside the scope of the BBA at inception, but later becomes subject to the BBA after acquiring a depository institution. To address that scenario, we suggest specifying that the insurer would be able to grandfather its outstanding surplus notes issued at least two years prior to the time of the acquisition, even though those outstanding notes do not include elements of Regulation Q and may have been issued after the original effective date of the BBA methodology. We suggest a two-year lookback to prevent against a scenario where an insurer is outside the scope of the BBA and is contemplating acquiring a bank, and therefore chooses to issue a series of surplus notes with the intention of minimizing Board jurisdiction.

These changes will promote a level playing field between mutual insurers that rely on surplus notes to raise capital, and stock insurers that have a wider menu of capital raising options. Without this expansion of the grandfathering mechanism, mutual insurers that issue traditional surplus notes after the effective date of the BBA methodology would be discouraged from considering affiliation with depository institutions.

The BBA methodology also includes two provisions that would in effect impose new quantitative caps on the use of surplus notes as capital instruments. This quantitative requirement deviates from current caps on surplus notes imposed by the states. Given how much control state regulators have in the issuance and management of surplus notes, we suggest that the Board look to the state regulators' current caps rather than imposing additional caps.

Finally, the treatment of surplus notes remains an open item within the ICS. We would therefore encourage alignment among the members of "Team USA" on this issue, to avoid negatively impacting our efforts to secure favorable treatment of surplus notes within the ICS.

IV. Capital Requirements for Asset Managers

Under the Board's proposed BBA methodology, an asset manager that is a subsidiary of an insurance company would be subject to a different capital requirement than if it were under a depository institution.

Operational and other risks exist without regard to decisions on how a company is structured. Therefore, a credible capital regime should eliminate any intentional or unintentional consequences that treat risks differently under different legal structures.

While our main concern is the consistent treatment of such entities regardless of corporate structure, we do favor the Basel III type approach for asset managers. That approach calculates risks for these entities as a function of the volume of business sold using reported revenue numbers. This is different than the RBC approach, which utilizes Book Adjusted Carrying Value (BACV). The RBC approach imposes higher risk charges for entities that are more capitalized (higher BACV), even if they are not necessarily riskier than less capitalized entities. We believe a revenue-based approach would do a better job of assessing the operational risk since it would impose a higher charge on those entities that have more sales and thus may be more prone to operational risk.

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We are grateful for your time and attention to our comments. If you would like to discuss this letter with us, please let us know.

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