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January 22, 2020

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

Introduction

State Farm Mutual® Automobile Insurance Company ("State Farm Mutual"), a mutual insurance company and a savings and loan holding company ("SLHC"), appreciates the opportunity to submit these comments and answers to questions on the Notice of Proposed Rulemaking ("NPR") regarding regulatory capital requirements for SLHCs engaged in insurance activities ("I-SLHCs") published by the Board of Governors of the Federal Reserve System ("Fed").[1]
State Farm Mutual appreciates the Fed's efforts to tailor its supervision of I-SLHCs. The Fed's task is complicated by the diversity of the I-SLHCs under its supervision, each with a markedly different business profile and organizational structure. This reality clearly hinders the Fed's ability to apply a uniform supervisory approach. State Farm Mutual believes that the Fed has made progress in understanding the different structures of I-SLHCs and that the NPR provides a

[1] The State Farm Mutual group is principally engaged in the business of insurance and is primarily focused on personal lines of insurance with the vast majority of its customers being individuals, families, and small businesses. State Farm Mutual is the leading writer of automobile insurance in the country and the State Farm Mutual group also includes the leading writer of homeowners and a leader in individual ordinary life insurance. The State Farm Mutual group includes State Farm Bank, F.S.B., an FDIC-insured federal savings bank established in 1999. State Farm Mutual is a "grandfathered" unitary savings and loan holding company, as defined in section 10(c)(9)(C) of the Home Owners' Loan Act. Almost 94% of the total assets of the group are related to insurance operations and the insurance operations account for 99% of the group's total revenues.

starting point to discuss how an I-SLHC can serve as a source of strength to its insured depository institution ("IDI").[2]

Nonetheless, there are critical aspects of the NPR that can be significantly improved to better effectuate Congress's statutory directives, to adhere to congressional intent concerning the preservation of state-based insurance regulation without duplication, and to simplify the applicable requirements for I-SLHCs to ensure that inappropriate banking regulatory principles do not improperly and adversely impact the business of insurance. Moreover, such improvements to the NPR can be made without compromising any of the Fed's supervisory obligations concerning I-SLHCs as directed by Congress.

State Farm Mutual respectfully submits that these improvements include fully recognizing state-based insurance regulation, capital requirements, and legal entity principles, while permitting a flexible approach to diverse I-SLHCs under the Building Blocks Approach ("BBA") that would allow a top tier, state-licensed insurance company to be exempt from completing the BBA calculation. In lieu of the BBA calculation, state-based capital requirements would be considered sufficient. These points are more fully discussed below, but the primary concerns can be summarized as follows:

- The NPR unnecessarily emphasizes a bank-centric and systemic supervisory approach to I-SLHCs. This emphasis ultimately conflicts with the statutory and public policy objectives and limitations sought by Congress.[3] As a result, the business of insurance remains subject to overlapping and conflicting regulation from the federal government and the states. The final rule should be faithful to the distinctions and state regulation of the business of insurance.

- The NPR encroaches upon numerous areas where Congress clearly sought to preserve state power including those under the McCarran-Ferguson Act of 1945 ("McCarran-Ferguson") by selectively including, parsing, and dismissing certain areas of state insurance regulation.[4] Ultimately, the NPR should not alter functional state regulation of the business of insurance.

- The BBA should be simplified, especially where the ultimate parent of an I-SLHC is a state-licensed insurance company. Although uniformity is a laudable goal, the NPR should provide additional flexibility for the Fed to recognize and apply distinctions to different types of I-SLHCs presenting different organizational structures and capital

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[2] For a more detailed discussion of the significant differences between banking and insurance, including differences in capital requirements, liquidity, accounting, and risk, see State Farm Mutual's comment letter filed in response to Federal Reserve Board Docket No. R-1442. State Farm Mutual Automobile Insurance Company, Comment Letter on Regulatory Capital Rules (Oct. 19, 2012); *see also* State Farm Mutual Automobile Insurance Company, Comment Letter on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities (Sept. 16, 2016). https://www.federalreserve.gov/SECRS/2016/December/20161227/R-1539/R-1539_091616_130502_561454238586_1.pdf ("2016 State Farm Mutual Comment Letter").

[3] *See infra* p. 4-7.

[4] 15 U.S.C. §§ 1011-1015 (2018).

adequacy risk. This flexibility should include exempting top-tier state-licensed insurance companies from the BBA capital calculation, and applying the National Association of Insurance Commissioners' ("NAIC") Risk Based Capital ("RBC") requirement and corresponding regulatory insurance entity intervention points for an I-SLHC.

- State Farm Mutual reaffirms its comments submitted on the June 14, 2016 Advance Notice of Proposed Rulemaking ("ANPR")[5] relating to the need for explicit recognition and adherence to fundamental legal entity principles governing the business of insurance in the United States, especially the principle that capital is not freely fungible across an insurance group.[6] As a matter of sound public policy, the Fed should identify its statutory authority and intent concerning the movement of capital within a regulated I-SLHC, including the Fed's assessment of its authority and limitations, such as those provided in the Policyholder Protection Act.[7]

- The proposed capital buffer on top of the minimum capital requirement is duplicative and unnecessary for most I-SLHCs, and can yield buffer amounts that are excessive in order for an I-SLHC to serve as a source of strength for an IDI.

- The NPR should remain focused on meeting the domestic supervisory obligations delegated to the Fed by Congress; it should not be used as a mechanism to explore concepts in developing capital standards for internationally active insurance groups. State Farm Mutual urges the Fed to constrain its capital rules for I-SLCHCs to its statutory charges under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[8] and the Home Owners' Loan Act ("HOLA")[9] as limited by McCarran-Ferguson.

- Finally, but no less significantly, the NPR should be modified to exclude entity-by-entity reporting requirements within an insurance block as well as consider the timing of reporting requirements. Entity-by-entity asset-liability reporting is unnecessary to satisfy the needs of adequate holding company capital and imposes reporting requirements that Congress largely rejected in permitting the continued use of Statutory Accounting Principles ("SAP"). The timing of reporting requirements should also be modified to avoid any undue compliance burdens, taking into account state-based reporting requirements and the timing of those requirements that form the basis for completing the BBA.

With those concerns in mind, State Farm Mutual commends the Fed's advancement of consolidated supervision that is not constrained to accounting conventions under Generally

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[5] 2016 State Farm Mutual Comment Letter, *supra* note 2; *see also* Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 Fed. Reg. 38631 (June 14, 2016).
[6] 2016 State Farm Mutual Comment Letter, *supra* note 2, at 8.
[7] 18 U.S.C. 1831o-1(c) (2018).
[8] Pub. L. No. 111-203, 124 Stat. 1376, 12 U.S.C. §§ 5301-5641 (2010).
[9] 12 U.S.C. §§ 1461-1470 (2018).

Accepted Accounting Principles ("GAAP"). Both state insurance regulators and Congress have determined that GAAP consolidation is unnecessary for the prudential supervision of the business of insurance. State Farm Mutual supports a consolidated approach freed from GAAP. It should be noted that SAP are far more conservative than GAAP. Notably, liabilities are not discounted, certain assets are not recognized, and revenue is booked as it is earned. The inherent conservatism in SAP provides prudential regulators of the business of insurance with added assurance of the financial strength of insurance groups and provides the regulated entities with a significant hedge against financial problems. The use of SAP provides a realistic and reliable mechanism for a consistent assessment of the financial health of an insurance group, whether the group is comprised of a single insurance company at the top of the house or consists of multiple entities with a non-insurance entity as the ultimate parent.

Currently, the BBA represents the most effective conceptual framework for evaluating the capital adequacy of an I-SLHC. However, although the BBA provides a foundation for approaching I-SLHCs, the Fed can further streamline the building blocks by relying upon the state-based regulatory capital structure and allowing more flexibility than proposed in the NPR.

Concerns with the NPR

a. The NPR still reflects a bank-centric and systemic approach to supervising I-SLHCs that conflicts with statutory and public policy objectives and limitations sought by Congress.

As set forth in the background discussion of the NPR,[10] express congressional authorization to the Fed in setting capital requirements for I-SLHCs is derived from HOLA as amended by the Dodd-Frank Act and section 171 of the Dodd-Frank Act (the "Collins Amendment"). However, these grants of authority did not constitute an open-ended invitation to the Fed to regulate the business of insurance or to set capital requirements in any manner it chose for I-SLHCs. Rather, the Fed's authority to set capital requirements must be construed in accordance with numerous other insurance-related statutory provisions and congressional directives in addition to the Dodd-Frank Act. These matters include, but are not limited to, McCarran-Ferguson limitations on the source of strength doctrine as it applies to insurance companies, and provisions in HOLA requiring reliance on existing state-based insurance reports and information in effectuating federal statutory and public policy objectives.[11]

State Farm Mutual strongly disagrees with the assertions of authority made by the Fed in the November 1, 2019 Final Rule governing non-insurance large depository holding companies.[12]

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[10] Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 Fed. Reg. 57240, 57241 (Oct. 24, 2019).

[11] Under the McCarran-Ferguson Act of 1945, Congress explicitly codified the primacy of the states in regulating the business of insurance. 15 U.S.C. § 1012 (2018). Congress specifically required the Board to use, to the fullest extent possible, reports and information provided to other federal and state regulatory agencies, including externally audited financial statements of an SLHC subsidiary. 12 U.S.C. § 1467a(b)(2)(B) (2018).

[12] Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 Fed. Reg. 59032 (Nov. 1, 2019).

Essentially, the Fed contended that under Section 10(g) of HOLA,[13] it possesses plenary authority to issue any regulations it is inclined to issue to ensure the safe and sound operation of an SLHC and ensure that the SLHC could serve as a source of strength for its IDI. The Fed further contended that the scope of this authority under HOLA was not limited by Congress's inclusion of Section 165 of the Dodd-Frank Act,[14] which expressly directed the Fed to issue "enhanced prudential standards" for companies deemed systemically important,[15] positing that because Congress did not expressly preclude the Fed from applying the Section 165 enhanced prudential standards to a broader set of financial institutions, its authority under HOLA is not limited by any such constraint. Therefore, it appears the Fed asserts that its general authority under HOLA trumps any law or series of enactments unless Congress expressly prohibits that authority.

Although State Farm Mutual acknowledges that the Fed's overarching congressionally delegated authority to supervise SLHCs is to ensure that the holding company can serve as a source of strength, there is no concurrence with the Fed's expansive view of its general statutory authority to equate Bank Holding Company ("BHC") supervision with SLHC supervision and an unfettered capacity to impose systemic risk enhanced prudential standards upon SLHCs. State Farm Mutual especially disputes such broad assertions of authority as applied to I-SLHCs and the business of insurance.

The Dodd-Frank Act and other enactments impacting thrifts and the business of insurance present a distinct statutory scheme expressing clear congressional directives to the Fed governing I-SLHCs and the business of insurance, which can be readily discerned and articulated as follows:[16]

- The thrift charter should be preserved and SLHCs and BHCs should be treated differently.
- Depository institutions should not serve as a source of strength to their holding companies and large BHCs should be held to minimum capital standards.[17]
- SLHCs should serve as a source of strength to their depository institutions.[18]
- Unlike Section 171 of the Dodd-Frank Act, the source of strength doctrine does not mandate that source of strength be achieved through minimum capital standards.[19]

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[13] *Id.* at 59054.
[14] 12 U.S.C. § 5325 (2018).
[15] Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 Fed. Reg. 59032, 59054 (Nov. 1, 2019). Systemically Important Financial Institutions generally refers to financial institutions whose failure or material financial distress would threaten the financial stability of the United States. *See* 12 U.S.C. § 5323(a) (2018).
[16] 15 U.S.C. § 1012 (2018); 12 U.S.C. § 1467a (2018); 12 U.S.C. § 5371(b) (2018).
[17] 156 CONG. REC. S3617 (daily ed. May 12, 2010) ("Letter from FDIC Chairman Sheila C. Bair"); *see also* The Changing Role of the FDIC Before the Subcomm. on TARP, Fin. Services, and Bailouts of Public and Private Programs of the H. Comm. On Oversight and Government Reform, 112th Cong. (June 22, 2011) (statement of Sheila C. Bair, Chairman FDIC).
[18] 12 U.S.C. § 1831o-1(a) (2018).
[19] 12 U.S.C. § 1831o-1 (2018).

- Where a depository institution holding company is an insurance company, the interests of insurance policyholders as determined by state regulators can take precedence over the source of strength doctrine.[20]
- The absence of any capital requirements at the holding company level is a concern—especially for systemically important financial institutions.[21]
- An SLHC is not to be supervised and subject to requirements intended to prevent systemic risk unless it is designated as a systemically important financial institution ("SIFI") by the Financial Stability Oversight Council ("FSOC").
- Although I–SLHCs present unique issues and should not be immune from holding company capital standards, state regulatory requirements governing the business of insurance should be respected and the Fed should make every effort to utilize and incorporate existing state requirements in setting federal rules for I-SLHCs with as minimal disruption and burden as possible to the insurance business model.[22]
- The Fed is authorized and expected to exclude certain insurance companies altogether from a minimum capital standards under Section 171.[23]
- Congress gave the Fed sufficient authority and flexibility to effectuate these objectives.[24]

Equally important, Congress did not do the following:

- Amend McCarran-Ferguson to authorize greater federal regulation of the business of insurance.
- Conflate the requirements governing I-SLHCs with those intended for SIFIs.
- Expand the source of strength doctrine beyond holding company support for the depository institution.

Taken together, Congress's approach to I-SLHCs can be simply described as:

- ***An SLHC is not a BHC and no SLHC is a SIFI unless designated by FSOC.***
- ***Capital standards at the holding company level for an I-SLHC may be appropriate to ensure that the holding company can serve as a source of strength to its underlying***

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[20] 12 U.S.C. § 1831o-1(c) (2018).
[21] Letter from FDIC Chairman Sheila C. Bair, *supra* note 17.
[22] "Indeed, nothing in Section 171 alters State capital requirements for insurance companies under State regulation nor the State guarantee funds. Section 171 directs the Federal Reserve to establish minimum consolidated capital standards with reference to the FDIC's Prompt Corrective Action regulations. But as I have publicly and repeatedly stressed, Section 171 does not direct the regulators to apply bank-centric capital standards to insurance entities which are already regulated by the States." Finding the Right Capital Regulations for Insurers: Hearing before the Subcommittee on Financial Institutions and Consumer Protection of the Committee on Banking, Housing, and Urban Affairs, 113th Cong. 4-9 (2014) (statement of Sen. Susan M. Collins)("Sen. Collins 2014 Statement") https://www.govinfo.gov/content/pkg/CHRG-113shrg89351/pdf/CHRG-113shrg89351.pdf; *see also* 12 U.S.C. § 1467a(2)(B) (2018).
[23] Insurance Capital Standards Clarification Act of 2014, Pub. L. No. 113-279, 128 Stat. 3017 (2014).
[24] Sen. Collins 2014 Statement, *supra* note 22.

IDI. However, McCarran-Ferguson remains in force where the holding company is significantly engaged in the business of insurance.

- ***Congress supports and accepts the adequacy of state-based insurance requirements. The Fed should defer to those state requirements and obligations to the greatest extent possible in establishing rules for insurance companies and I-SLHCs.***

The NPR is a hybrid—attempting to fashion state-based insurance capital requirements into its more monolithic bank-regulatory framework. Indeed, the NPR lays the predicate for applying more onerous systemic risk-like banking supervisory requirements to I-SLHCs. For example, in the NPR's background discussion, the Fed states that among the objectives in enacting the Dodd-Frank Act was to "ensure fair and appropriate supervision of depository institutions without regard to the size or type of charter…"[25] However, the Dodd-Frank Act is replete with distinctions between various types of banking organizations, particularly based on the size and activities of the organization.[26] Moreover, although the Fed has repeatedly sought to phase out the non-banking activities of grandfathered unitary SLHCs,[27] Congress has taken no such action. Indeed in one of the most significant provisions of the Dodd-Frank Act — the automatic designation of BHCs of a certain size as systemically important — Congress excluded savings and loan holding companies. All of these policy actions represent a clear congressional affirmation to distinguish the treatment of companies on the basis of size and charter. Furthermore, in Question 33 of the NPR concerning a capital buffer and related remedial measures, the Fed flatly declares that measures are intended to enhance the "resiliency of the financial system." Although the stability of the financial system may be an important goal, Congress clearly established an entirely different regime for addressing systemic risk that is entirely divorced from I-SLHC regulatory requirements.[28] Consequently, the final rule should be faithful to these distinctions; it should not conflate capital requirements for individual I-SLHCs with unrelated provisions intended to address financial stability.

b. The NPR exhibits reluctance to fully embrace the adequacy of state-based insurance regulation and capital requirements; the proposal encroaches upon the limits of federal authority under McCarran-Ferguson by selectively choosing aspects of state law to accept or reject.

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[25] Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 Fed. Reg. 57240, 57241 (Oct. 24, 2019).

[26] Supervision and Regulation Letters, addressing policy and procedural matters related to the Fed's supervisory responsibilities, also generally contain an "Applicability" box which describes the type and size of the institution that the guidance applies to. Although guidance does not carry the force of law, it does provide insight into Fed practice regarding the size and type of supervised institution to ensure guidance is properly applicable.

[27] *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Report to Congress and the Financial Stability Council Pursuant to Section 620 of the Dodd-Frank Act, 28-30 (2016) https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160908a1.pdf.

[28] This issue is discussed further in State Farm Mutual's response to Question 33.

For several years the Fed's actions have indicated a certain level of skepticism concerning the sufficiency of state regulation of insurers.[29] On numerous occasions, the Fed has sought to graft a banking regime upon I-SLHCs.[30] In multiple meetings concerning the inappropriateness of applying bank standards to insurers, senior Fed staff contended that I-SLHCs in existence for decades affirmatively "chose" to own a bank and subject themselves to the Fed's bank-oriented supervisory regime and capital standards.[31] This was asserted notwithstanding the lack of any explicit congressional authority and intent to regulate I-SLHCs like banks. Moreover, only after intense congressional scrutiny and enactment of the first substantive amendment to the Dodd-Frank Act did the Fed reconsider its course.[32]

The NPR certainly reflects this change in approach and utilization of insurance expertise by substantially incorporating state-based insurance requirements into its capital rule. However, the NPR still expresses a significant degree of skepticism regarding state practices and capabilities in offering its own modifications to state-based requirements within the insurance building blocks. The fundamental basis for this skepticism appears to be a failure to recognize the differences in risks presented by insurance lines of business from those presented by banking lines of business.

This selective approach to accepting state capital is untenable: either accredited state insurance solvency regulation is sufficient or it is not. The Fed should not be putting itself in the position of picking and choosing what it likes or dislikes about state law and effectively acting as a second state insurance regulator. While there can be an honest debate about the pros and cons of surplus notes, permitted practices, and other state practices, the final decision should be vested with the prudential regulator of the business of insurance. To do otherwise creates conflicting systems of capital supervision for the business of insurance. Moreover, the Fed's approach invites unwarranted entanglements into other everyday insurance matters with any nexus to capital clearly encroaching into the heart of the business of insurance and contrary to the plain language of McCarran-Ferguson.

As the Fed is aware, McCarran-Ferguson generally places the regulation of the business of insurance with the states. Although in enacting the Dodd-Frank Act Congress understood that insurance companies could be affected by provisions of the new law, it made clear its intent to maintain functional state regulation of the business of insurance.[33] Financial solvency or capital adequacy of I-SLHCs is one area where the Fed should defer to the states.

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[29] This skepticism has existed notwithstanding the relatively low number of state-regulated insurance company failures compared to banks.

[30] *See, e.g.*, SR 11-13: Guidance Regarding Prior Notices with Respect to Dividend Declarations by Savings Association Subsidiaries of Savings and Loan Holding Companies (July 25, 2011) https://www.federalreserve.gov/supervisionreg/srletters/sr1113.htm.

[31] *See* Elizabeth D. Festa, *Fed Takes on Dodd-Frank Conflicts*, ThinkAdvisor, May 09, 2013, https://www.thinkadvisor.com/2013/05/09/fed-takes-on-dodd-frank-conflicts/?slreturn=20200016125225.

[32] The Collins Amendment was approved on a bipartisan basis without any congressional expression of opposition. *See* 160 CONG. REC. H9019-20 (daily ed. Dec. 10, 2014).

[33] S. Rep. No. 111-176, at 84 (2010).

This is especially true today as the evolving state-based regulation of insurance entities continues to enhance the solvency supervision of holding companies that includes entities conducting the business of insurance. Such enhancements include the Own Risk Solvency Assessment ("ORSA") report, Form F filings, Supervisory Colleges, and the recent development of the Group Capital Calculation ("GCC") evaluation tool by the NAIC, which essentially develops the same capital calculation as the NPR. Furthermore, when focused on I-SLHCs, the Fed should rely on the NAIC RBC requirement that sets forth minimum capital requirements and corresponding regulatory intervention points for an insurance entity as it essentially produces the same results as the BBA and GCC.

Additionally, State Farm Mutual notes that the NPR, on page 57261, provides in response to the creation of the buffer that "[T]he proposed rule broadens 'distributions' to include discretionary dividends on participating insurance policies because, for mutual insurance companies, these payments are the equivalent of stock dividends".[34] State Farm Mutual disagrees with this statement. As stated in filings with our regulators, it has been noted by State Farm Mutual that the return of premium to mutual policyholders is not a "capital action". The return of premium is not and should not be considered the equivalent of return of capital and is not treated as such under insurance regulatory scheme.

c. The NPR should provide sufficient flexibility for the Fed to recognize and apply distinctions to different types of I-SLHCs presenting different types of regulatory risk. In particular, the NPR should be simplified where the ultimate parent of an I-SLHC is a state-licensed insurance company.

Nowhere is the need for simplified regulatory treatment and deferral to state standards pursuant to federal law and congressional intent more clear and compelling than for I-SLHCs where the holding company itself is a state-regulated insurance entity. Unlike SIFIs, where Congress mandated the adoption of capital rules for such companies, HOLA, which governs thrifts, makes the adoption of capital rules discretionary for SLHCs.[35] The only other federal statute that seeks minimum capital rules for such holding companies is the Collins Amendment to the Dodd-Frank Act as originally enacted. Although many believed the Collins Amendment authorized the Fed to utilize existing state risk-based capital standards to satisfy this minimum capital requirement, including Senator Collins herself,[36] any doubt on this subject was addressed by the subsequent enactment of the Insurance Capital Standards Clarification Act of 2014 ("Clarification Act"),[37] which gave the Fed explicit authority to treat insurance companies differently, including deferring to the existing state regulatory capital framework.

Congressional intent on this matter was further amplified through a provision in the Clarification Act relating to the accounting requirements governing certain I-SLHCs. Specifically,

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[34] Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 Fed. Reg. 57240, 57261 (Oct. 24, 2019).
[35] 12 U.S.C. § 1467a(g)(1) (2018).
[36] Sen. Collins 2014 Statement, *supra* note 22.
[37] Insurance Capital Standards Clarification Act of 2014, Pub. L. No. 113-279, 128 Stat. 3017 (2014).

Congress prohibited the Fed from requiring SLHCs, that prepare financial statements using only SAP, to prepare financial statements using GAAP. Inclusion of this provision had three impacts. First, it avoided imposing an undue burden and hundreds of millions of dollars of additional costs on several insurance companies for a negligible or nonexistent supervisory benefit. Second, it reflected Congress's unambiguous decision to validate the sufficiency of such SAP statements as well as the underlying state-based insurance RBC requirements for which they are utilized in satisfying any federally established capital standards. Finally, it allowed entity-based SAP statements to be utilized for supervisory purposes where the Fed has traditionally relied upon consolidated financial statements, particularly where insurance RBC can serve as a proxy for "consolidation" as this term has been traditionally applied by the Fed. In fact, the accounting provision makes little sense without such an understanding; otherwise, SAP and state-based requirements tied to SAP would serve no regulatory purpose. Indeed, it appears that reliance on SAP statements and the congressional directive on the matter provides the very foundation of the Fed's BBA (discussed in more detail below).

Taken to its natural conclusion, the Fed should consider viewing a top-tier insurance SLHC as wholly exempt from any capital requirement under both HOLA and the Collins Amendment as further amended by the Clarification Act. To the extent the Fed is unwilling to adopt an exclusion for such top-tier I-SLHCs, a sound alternative is to simply apply the NAIC's RBC requirement to the top-tier holding company without the need for any further sub-calculations, analysis, or reporting downstream from the "top of the house". Indeed, with the Fed now making clear that a "consolidated" capital requirement is not narrowly confined to an accounting term of art, but can reflect an aggregation of the whole, there is no more consolidated I-SLHC than a top-tier insurer subject to existing state-based capital requirements and reporting at the top of the house. Applying the BBA to the State Farm group has demonstrated that the BBA ratio is virtually the same as the NAIC RBC ratio for State Farm Mutual. Applying the BBA does not produce significantly different results, but does create additional burden.

As contended in previous comments to the Fed, NAIC RBC most effectively captures all of the material risks associated with insurance operations and investments and does so in a manner that is tailored to the business models and asset utilization strategies of insurance-based companies. The NAIC RBC also provides intervention points, and having consistent intervention points would solidify the separate regulatory roles and remove duplication or counterproductive actions by different regulators. To insist upon further detailed analysis or reporting on an entity-by-entity basis not only imposes duplicative, burdensome, and unnecessary new requirements, it contradicts what Congress has directed the Fed to consider regarding I-SLHCs and the need to require such has not been demonstrated.[38]

An additional advantage of accepting NAIC RBC in certain circumstances is that issues concerning permitted practices, surplus notes, and transitional measures such as Principal

[38] The same general principles should apply to non-top-tier insurer I-SLHC, such that the Fed should look to the required capital of the highest insurer within a block, regardless of the types of subsidiaries contained within that block—both insurance and non-insurance alike.

Based Reserving ("PBR") are addressed. As for transitional measures, such as PBR, insurers should not be required to calculate reserves in a manner that is inconsistent with SAP. Additionally, disallowing or prohibiting the use of capital as a result of a permitted practice distorts the capital adequacy calculation under the BBA as compared to RBC, in which regulators are approving the permitted practices entirely related to the business of insurance. Should the Fed insist upon differentiating among permitted practices when not accepting RBC of a top-tier I-SLHC, one supervisory oversight consideration would be to differentiate between permitted practices that allow capital to be recognized for a legal transaction that could not occur without the permitted practice versus a permitted practice for a transaction that could otherwise occur.

d. State Farm Mutual reaffirms comments submitted on the June 14, 2016 Advance Notice of Proposed Rulemaking relating to the need for explicit recognition and adherence to fundamental legal entity principles governing the business of insurance in the United States, especially the principle that capital is not freely fungible across an insurance group.

One of the overarching concerns State Farm Mutual has with any group capital standard concept is the underlying premise that — notwithstanding the longstanding legal entity framework governing U.S. insurance groups — any form of a group capital requirement presumes that capital is freely fungible between parent, subsidiaries, and affiliates of regulated groups. This presumption applies to both regulator and third party efforts that assume capital in one part or in the entirety of the group is available to bail out or cross-subsidize another part of the group. As a starting principle, the interests of insurance policyholders should not be subordinated to the interests of depositors. Nor should the interests of depositors be subordinated to the interests of insurance claimants. Moreover, balancing the interests of depositors and claimants can be satisfied in a manner that does not offend the long standing regulation of the business of insurance. It is our position that McCarran-Ferguson does not enable the Fed to intrude on the business of insurance with its safety and soundness doctrine, in essence defeating any assumption that the claims of depositors are paramount to the claims of insurance claimants. In insurance, we oppose politically-motivated efforts to suppress insurance rates and force cross-subsidies from the policyholders of one state or entity to the benefit of policyholders in another state or entity. Furthermore, insurance rate regulation would become a race to the bottom for solvency purposes if capital could freely move between entities. That is, some regulators would be tempted to suppress rates in order to force subsidies from affiliates or a parent, which is antithetical to prudential regulation.

As articulated to the Fed on several occasions, unlike banking, U.S. insurance regulation is legal entity focused with strict oversight and required regulatory review of all company-proposed, material inter-affiliate transactions. For example, the state solvency framework utilizes a "Windows and Walls" philosophy wherein the "Walls" represent the strict limitations on movement of capital between regulated insurers and other members within the group. In addition, history has revealed the difficulties in extracting and moving affiliated capital from one jurisdiction to another in times of financial stress within a group.[39] Moreover, NAIC efforts to develop a GCC explicitly recognizes this limitation by characterizing such GCC as a capital assessment tool as opposed to a prescribed standard.

As stated above, the statutory purpose for imposing a holding company capital standard is limited to serving as a source of strength to the IDI. To the extent the Fed has articulated systemic justifications for components of the capital requirement and has not responded to our ANPR comments, State Farm Mutual is deeply concerned that the Fed may view fungibility of capital very differently for insurance groups than insurance regulators—and view fungible capital as an indispensable supervisory tool.

At a minimum, as a matter of public policy the Fed should identify both its statutory authority and intent concerning the movement of capital within a regulated I-SLHC. Such an explanation should include the Fed's assessment of its authority and limitations, such as those provided in the Policyholder Protection Act and McCarran-Ferguson.[40]

e. The capital buffer is unnecessary, especially as applied to a top-tier I-SLHC satisfying its state based capital requirements.

In State Farm Mutual's view, the proposed capital buffer represents incompatible banking regulation interjected into the insurance model. For State Farm Mutual and many other I-SLHCs predominantly engaged in the business of insurance, the buffer is unnecessary. To the extent the Fed seeks capital availability to ensure that an I-SLHC can serve as a source of strength to its IDI, that level of capital should be rationally related to the size of the IDI and not the holding company as proposed in the NPR. For example, in proposing a capital buffer that is tied to the size of I-SLHC, the NPR would require State Farm Mutual to hold capital that exceeds the size of the bank many times over. This is an absurd outcome and certainly one that should be rejected by the Fed. Instead, the Fed should consider accepting the adequacy of existing capital within a well-capitalized I-SLHC as sufficient.[41]

f. This NPR should not be used as a platform for accommodating international efforts to set capital standards for internationally active insurance groups.

State Farm Mutual is concerned about the degree that the formulation of this rule is intertwined with efforts at the International Association of Insurance Supervisors to establish an international insurance capital standard ("ICS"). State Farm Mutual has long opposed the ICS project, and its orientation towards systemic risk and creditor protection, as an inappropriate and duplicative effort to the U.S. legal framework governing insurance. Nonetheless, although State Farm Mutual is unaware of any internationally active insurance group that is also an I-

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[39] Even the IAIS appears more willing to acknowledge limits on fungibility of capital as it relates to liquidity. *See e.g.*, International Association of Insurance Supervisors, Draft Application Paper on Liquidity Risk Management for Public Consultation (Nov. 19, 2019), https://www.iaisweb.org/page/consultations/current-consultations/draft-application-paper-on-liquidity-risk-management

[40] 12 U.S.C. § 1831o-1(c)(2018); 15 U.S.C. §§ 1011-1015 (2018).

[41] For further discussion, see State Farm Mutual's answer to Question 33.

SLHC subject to the Fed's current supervision, the construct of this NPR and the questions presented by the Fed suggest a desire to influence aggregation-method proposals that aim to satisfy comparable outcomes to the ICS. Although State Farm Mutual supports the Fed's efforts to be constructive in international forums, it is counterproductive here. This international focus contributes to unnecessary complications as insurance companies that are not I-SLHCs seek to shape many of the technical components of the rule as a pre-cursor to its use in international discussions. State Farm Mutual urges the Fed to constrain its development of capital rules for I-SLHCs to its statutory charges under the Dodd-Frank Act and HOLA as limited by McCarran-Ferguson.

g. The NPR's insurance reporting requirements are burdensome and should be simplified; reporting dates should be modified.

The NPR imposes reporting requirements that are unnecessarily burdensome, including some that seem contrary to congressional intent. For example, the NPR requires each legal entity to be separately listed with a disclosure of that entity's assets and liabilities regardless of its materiality to the I-SLHC and its necessity to complete the calculation. Consistent with State Farm Mutual's arguments that NAIC RBC is the only capital measure needed for purposes of evaluating the capital of an insurance block, there is no meaningful purpose for reporting this level of granularity to ensure an I-SLHC's capital adequacy. Moreover, the requirement contravenes a significant benefit of regulatory efficiency that Congress enacted in the Clarification Act, which precluded the Fed from mandating the use of GAAP for I-SLHCs such as State Farm Mutual. The types of information sought by the Fed, if relevant, are available through supervisory processes and other mechanisms, including FR Y-6 or the ORSA report.

While it is arguable that entity-by-entity asset/liability reporting is not the same as requiring financial statements to be prepared using GAAP, as a practical matter, the proposal requires producing the same type of information needed under GAAP requirements—and asking for its production is inconsistent with the spirit of congressional intent under the Clarification Act. State Farm Mutual respectfully requests that this requirement be eliminated in the final rule.

Similarly, the calculations sought regarding transitional measures such as PBR should be eliminated and the Fed should continue to rely entirely upon the insurance capital requirement for the applicable insurance building block.

In the circumstance that NAIC RBC is not accepted for an I-SLHC, then certain reporting requirements should be adjusted. The NPR contains a proposed reporting date of March 15 to submit the capital calculation. This date closely coincides with the deadline for annual reporting to the NAIC and would place additional demands upon the same financial operations staff within a very short time frame. The reporting date should be moved back to June 1 to achieve greater efficiency. Additionally, the proposed Form FR Q-1 includes requirements relating to the accuracy of information that, as applied to a state-regulated insurance company, is duplicative of state law. If the Fed adopts Form FR Q-1, there should be consideration made to allow I-SLHCs that would be subject to the BBA to not be required to file until 2022, in order to allow the appropriate substantive procedures and controls to be implemented.

Conclusion

State Farm Mutual applauds the Fed's revised approach to consolidation and supports the objective of the BBA with the modifications suggested in this comment letter. Specifically, banking requirements should be subordinated to insurance requirements for a state-regulated insurance company; the Fed should fully embrace accredited state-approved capital requirements in their entirety. Efforts by the Fed to select aspects of state-based regulation it accepts or rejects threatens to violate McCarran-Ferguson and other congressional directives concerning the business of insurance.

The capital of a top-tier I-SLHC provides a complete consolidated picture of an I-SLHC that should be sufficient to satisfy all of the Fed's statutory needs relating to capital in order to ensure the safe and sound operation of the holding company and its capacity to financially support its IDI. The Fed should defer to state reporting requirements to the greatest extent possible and not impose onerous GAAP-like entity-by-entity reporting requirements that Congress sought to avoid in explicitly accepting SAP.

State Farm Mutual's detailed answers to the Fed's questions in the NPR follow. Thank you for your consideration.

Very truly yours,

Stephen McManus
Senior Vice President and General Counsel
State Farm Mutual Automobile Insurance Company

State Farm Mutual's Response to ANPR Questions:

Overview of the BBA

Question 1: *The IAIS is currently considering a MAV approach for the ICS; in contrast, the BBA aggregates existing company-level capital requirements throughout an organization to assess capital adequacy at various levels of the organization, including at the enterprise level. What are the comparative strengths and weaknesses of the proposed approaches? How might an aggregation-based approach better reflect the risks and economics of the insurance business in the U.S.?*

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. Although an aggregation-based approach does measure solvency at the parent level of the holding company, the state-based NAIC RBC without additional calculation is more appropriate for the business of insurance in the United States.

It should be noted that Statutory Accounting Principles (SAP) are far more conservative than GAAP. Notably, liabilities are not discounted, certain assets are not recognized, and revenue is booked as it is earned. The inherent conservatism in SAP provides prudential regulators of the business of insurance with added assurance of the financial strength of insurance groups and provides the regulated entities with a significant hedge against financial problems. The use of SAP provides a realistic and reliable mechanism for a consistent assessment of the financial health of an insurance group, whether the group is comprised of a single insurance company at the top of the house or consists of multiple entities with a non-insurance entity as the ultimate parent.

Question 2*: In what ways would an aggregation-based approach be a viable alternative to the ICS? What criteria should be used to assess comparability to determine whether an aggregation-based approach is outcome-equivalent to the ICS?*

The ICS is duplicative of what can be achieved in the U.S. through existing means and supervisory collaboration, specifically risk based capital standards and regulation and existing supervisory authority. State Farm Mutual advocates for the development of an alternative to the proposed ICS that recognizes the established state-based regulatory and legal environment surrounding insurance in the United States. Although State Farm Mutual supports the Board's efforts to be constructive in international forums, State Farm Mutual is unaware of any internationally active I-SLHCs, and the international focus of this NPR contributes to unnecessary complications as insurance companies who are not I-SLHCs seek to shape many of the technical components of the rule as a precursor to its use in international discussions.

Dodd-Frank Act Capital Calculation

***Question 7**: Should the generally applicable minimum leverage ratio be excluded from the section 171 calculation?*

As made clear under the Collins Amendment Clarification, the minimum leverage ratio does not need to be applied to an entity regulated by a state insurance regulator. Therefore, it should be excluded from the section 171 calculation for entities regulated by a state insurance regulator. We believe this requirement of the Collins Amendment remains generally applicable to I-SLHCs where the bank and other financial activities occur outside of insurance company covered by the Collins Clarification.

***Question 12:** What are the advantages and disadvantages of including all insurance depository institution holding companies (including bank holding companies significantly engaged in insurance activities and insurance depository institution holding companies that control covered savings associations) within the scope of the final BBA rule, as planned?*

Form FR Q-1 currently does not accommodate a group structure that includes two mutual insurance companies. In the instance where a top-tier I-SLHC controls a second mutual insurance company through common management, the second mutual company should be included in the FR Q-1 according to the instructions. However, the methodology only accommodates entities under control through equity ownership.

Applicable Capital Framework

***Question 13:** The Board invites comment on the proposed approach to determine applicable capital frameworks. What are the advantages and disadvantages of the approach? What is the burden associated with the proposed approach?*

In calculating the BBA, determining the Applicable Capital Framework is not clear or intuitive. The BBA methodology states to select "U.S. federal banking capital rules" for a company not engaged in insurance or reinsurance underwriting. Using the example of a real estate investment LLC that is owned by an insurance company, the BBA methodology instructs that the Applicable Capital Framework should be U.S. federal banking capital rules, which is inconsistent with the operations of the LLC. A better alternative in this example would be to assign the initial capital framework as NAIC RBC and then, if the entity meets the definition of a material financial entity, then assign the Applicable Capital Framework as U.S. federal banking capital rules.

Capital-Regulated Companies and Material Financial Entities as Building Block Parents

***Question 14:** What other definitions of materiality, if any, should the Board consider for use in the BBA? Examples may include a threshold based on size, off balance sheet exposure, or activities including derivatives or securitizations.*

Question 15: *What thresholds, other than the proposed threshold for exposure as a percentage of total assets, should the Board consider for use in the BBA's definition of materiality? What are advantages and disadvantages of using a threshold based on the top-tier depository institution holding company's building block capital requirement?*

Questions 14 & 15: It is suggested that a materiality threshold be established for determining whether or not a subsidiary or affiliate of a regulated I-SLHC needs to be disaggregated and its required capital calculated separately from its parent. Also, certain non-bank subsidiaries and affiliates of regulated insurers that support insurance operations (e.g. investment subsidiaries, insurance agencies, services providers, etc.), should remain included in their parent's RBC asset risk charges and not be required to be broken out.

Question 16: *The Board invites comment on the use of the material financial entity concept. What are the advantages and disadvantages to the approach? What burden, if any, is associated with the proposed approach?*

Advantages of the material financial entity concept is that there are a number of entities not material to the solvency of a holding company and the material financial entity concept reduces the burden for entities that do not fit easily into the BBA calculation. However, there is a disadvantage in applying banking capital rules to a non-bank entity.

Approach Where Scalars are Not Specified

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

To the best of our knowledge, the Board does not currently supervise any internationally active I-SLHCs. Therefore, State Farm Mutual considers it premature for the Board to develop scalars for the IAIGs, as the Board does not currently supervise any internationally active I-SLHCs.

Question 24: *The Board invites comments on all aspects of the proposed adjustments to capital requirements. Should any of the adjustments be applied differently? What other adjustments should the Board consider?*

State Farm Mutual generally does not support any adjustments to capital requirements otherwise prescribed under federal or state law. The hallmark of the aggregation methodology is that it leverages existing regulatory capital requirements and supervisory regimes. Therefore, caution should be taken before making adjustments to those regimes. For other company specific permitted practices, State Farm Mutual believes these should continue to be used. They have been subject to individual state regulatory approval and as such should be considered acceptable without adjustment. State Farm Mutual feels strongly that a top-tier I-SLHC should not be confronted with different capital requirements and intervention points from various regulators.

Capital

Question 25: *The Board invites comments on all aspects of the proposed adjustments to available capital. Should any of the adjustments be applied differently? What other adjustments should the Board consider?*

Question 26: *What other criteria, if any, should the Board consider for determining available capital under the BBA?*

Questions 25 & 26: If accepting NAIC RBC for a top-tier I-SLHC, these issues are not applicable. Please see our comment letter for further discussion.

Question 28: *Are there other approaches, other than grandfathering, that the Board should consider to address surplus notes issued by insurance depository institution holding companies or their subsidiaries before November 1, 2019?*

Surplus notes should be accepted in their entirety. In State Farm Mutual's view, the proposed restrictions on surplus notes constitute an overreach that impinges upon the regulation of the business of insurance reserved to the states under McCarran-Ferguson, which was reinforced through the Collins Amendment Clarification.

The BBA Ratio and Proposed Minimum Requirement

Question 32: *The Board invites comment on the proposed minimum capital requirement. What are the advantages and disadvantages of the approach? What is the burden associated with the proposed approach?*

Assuming that the NAIC RBC is not acceptable alternative for a top-tier regulated parent insurer of an I-SLHC which provides capital requirements and intervention point, minimum capital ratio should be similar to those imposed by the NAIC RBC.

Minimum Capital Buffers

Question 33: *The Board invites comment on the proposed minimum capital buffer. What are the advantages and disadvantages of the buffer? What is the burden associated with the buffer?*

State Farm Mutual believes the proposed buffer does not bear a rational relationship to the Board's statutory authority and congressional directives governing the supervision of SLHCs in general and I-SLHCs in particular. Indeed, the NPR flatly declares that the buffer and remedial measures for failing to meet it are intended to enhance the "resiliency of the financial system." Consequently, far from simply ensuring that an I-SLHC can serve as a source of strength for its IDI, the buffer appears to be an enhanced prudential standard that Congress reserved exclusively for SIFIs under Section 165 of the Dodd Frank Act. This policy rationale makes no sense in that SLHCs do not pose the same level of risk to the economy as SIFIs and more importantly, a bank regulatory template is inappropriate for the risk presented by I-SLHCs. State Farm Mutual believes the minimum capital level as expressed in the Building Block ratio should be sufficient to ensure that an I-SLHC can serve as a source a strength for its IDI. To the extent that the Board determines that additional mechanisms are necessary beyond the NAIC RBC capital requirements, such mechanisms should be established for evaluative purposes only and not as an additional required capital standard.

Reporting Form and Disclosure Requirements

Question 34: *What should the Board consider in determining the reporting cycle for the BBA?*

The Board sets the annual reporting deadline for proposed Form FR Q–1 as March 15th of each year. This date coincides with submission of NAIC Reports presenting a duplicative reporting burden on supervised I-SLHCs. We recommend setting the annual submission date as no earlier than June 1.

Question 35: *Aside from what is currently proposed for public disclosure under the BBA and associated reporting form, should additional information submitted to the Board pursuant to the BBA be made public?*

State Farm Mutual strongly supports the position that all documentation and information related to the BBA and any additional information should be treated as confidential supervisory information. This position is in line with the NAIC Group Capital Calculation.

Cost-Benefit of Proposed Rule

Question 36: *The Board invites comment on all aspects of the foregoing evaluation of the costs and benefits of the proposed rule. Are there additional costs or benefits that the Board should consider? Would the magnitude of costs or benefits be different than as described above?*

Please see our letter for additional comments, however, for a top-tier parent I-SLHC that is predominantly engaged in the business of insurance this is a wholly unnecessary exercise as that top-tier parent RBC provides the equivalent calculation.