



May 13, 2019

Financial Stability Oversight Council
Attn: Mark Schlegel
1500 Pennsylvania Avenue NW, Room 2208B
Washington, DC 20220

Re: FSOC Proposed Interpretive Guidance Regarding the Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies

RIN 4030-ZA00

Dear Mr. Schlegel:

The ACLI advocates on behalf of 280-member companies dedicated to providing products and services that promote consumers' financial and retirement security. Ninety million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families relying on life insurers' products for peace of mind. ACLI members represent ninety-five percent of industry assets in the United States.

Overall, ACLI is highly encouraged with the Financial Stability Oversight Council's ("the Council's") stated objectives to ensure its work is clear, transparent and analytically rigorous, and to enhance engagement with companies, existing primary regulators and other stakeholders. Most significantly, the ACLI supports the Council's proposal to develop and prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach (ABA). The ACLI also endorses reforms to enhance analytical rigor and transparency in the processes the Council would undertake if it were to consider designating a nonbank entity as a SIFI subject to supervision by the Federal Reserve, including procedural adjustments such as condensing the three-stage determination process into two stages and requiring a cost-benefit analysis prior to any determination. Finally, we value the emphasis throughout the proposal on collaboration with the primary regulators, including state insurance commissioners, for both the preferred activities-based approach as well as any possible entity-based designations.

We acknowledge that the Proposed Guidance aligns with the U.S. Treasury's November 2017 report to the President of the United States on FSOC Designations, and that Treasury's FSOC report contains a number of important recommendations advocated by ACLI. These include prioritizing a sector-wide ABA approach to potential risks posed by nonbank financial companies; greater coordination and reliance on primary functional regulators; increasing the analytic rigor of determination analyses; improving engagement and transparency in the determinations process; and providing a clear "off-ramp" for designated nonbank financial companies and those under

consideration. The report reflects many of the principles of transparency, accountability and due process supported by ACLI and its members and included in the Proposed Guidance.

Below is a discussion of topics of importance to ACLI members addressed in the Proposed Guidance. Rather than providing answers to each of the specific questions in the release, we have incorporated what we hope is responsive information under the various headings.

We Agree that the FSOC Should Prioritize an Activities-Based Approach to Potential Risks Posed by Nonbank Financial Companies

ACLI believes the ABA approach described in the Proposed Guidance is an appropriate method whereby FSOC can monitor diverse financial markets and developments in consultation with primary functional regulators. We support prioritizing the use of an ABA to identify, assess, and address potential risks and considering entity-based designation as a last resort.

While we believe the FSOC has a vital role to play in helping identify and mitigate potential systemic risk in the U.S. economy, the use of its authority with respect to past designations of nonbank entities as systemically important financial institutions (SIFI) was arbitrary, inconsistent and highly problematic. The use of the Council's authority to designate individual firms as nonbank SIFIs ignored more efficient and effective regulatory tools to mitigate perceived systemic risk concerns and diverted important resources away from the FSOC's critical role as a cross-sectoral macroprudential overseer of the economy, able to identify potential systemic risk in a timely fashion.

The designation of insurers produced duplicative supervision and regulation requirements, unnecessary regulatory costs and burdens, and harmed competition in the insurance marketplace without identifying or mitigating perceived systemic risk. We are therefore pleased with and support the FSOC's recent decision to remove its insurance company systemically important financial institution designations and its intent to adopt an ABA to systemic risk moving forward. The development and implementation of an ABA addresses an important gap in the existing interpretive guidance which is focused exclusively on guidance relating to Section 113 authority to designate and require supervision and regulation of U.S. nonbank financial companies by the Board of Governors. In our view, prioritizing an ABA appropriately focuses FSOC's resources on identifying, assessing and mitigating potential systemic risk to U.S. financial stability. An ABA is more efficient and effective than subjecting a handful of insurers, already highly supervised and regulated by state insurance regulators, to another layer of duplicative and potentially conflicting supervision and regulation, particularly if based solely on size or perceived complexity. The use of an ABA appropriately aligns with the FSOC's principal role of making advisory recommendations to primary financial regulatory agencies on new or heightened safeguards for financial activities that could increase risks to the U.S. financial markets.

ACLI is highly encouraged by the proposed interpretive guidance, and particularly with the decision to transition away from entity-based determinations toward an ABA. ACLI particularly applauds the emphasis placed in the Proposed Guidance on leveraging the knowledge and expertise of existing primary financial regulatory agencies to mitigate identified potential risks to U.S. financial stability.

Recent and On-Going Enhancements to the State-Based Insurance System to Support Financial Stability

Insurance companies have experienced prudential regulators that have greatly enhanced existing and increased the use of new tools to oversee and effectively regulate the industry. In the last decade, state insurance holding company laws and group supervision practices have been

strengthened and expanded to enable state regulators to be even more vigilant in identifying, and aggressive in addressing, issues of concern that might jeopardize the insurance company as a whole. For example, insurance companies or groups are now required to submit their own risk and solvency assessments to state insurance regulators, who routinely review them with the group's management in cooperation with other regulators. Additionally, new holding company laws codified existing practices granting state insurance regulators the authority to initiate and establish, and participate in, a supervisory college. Supervisory colleges are an effective forum for an insurers' principal regulators to come together to identify, analyze, and mitigate any potential group-wide risks with respect to an insurer, and enhances supervision through coordination and information-sharing among principal regulators. Prudential oversight of insurance companies through the state-based system continues to be demonstrably strong and effective as it evolves to meet ongoing challenges.

Recently, the National Association of Insurance Commissioners has undertaken a new macroprudential initiative (MPI), which is designed to provide financial stability by analyzing existing macroeconomic trends, post-financial crisis regulatory reforms, and identifying potential enhancements and/or additions to further improve state regulators' ability to address macroprudential impacts. The goal of the MPI is to consider "new or improved tools" to enable regulators to better monitor and respond to the impact of external financial and economic risks on insurers that might be transmitted externally, and to increase awareness of state legislators' monitoring capabilities regarding macroprudential trends. The NAIC has several MPI workstreams underway, including improved liquidity and counterparty risk exposure monitoring tools. It's worth acknowledging the important alignment of the proposed interpretive guidance on ABA with the ongoing development of an activities-based approach at the global level through the International Association of Insurance Supervisors' Holistic Framework for Systemic Risk in the Insurance Sector and the NAIC's MPI. We encourage FSOC, as we have others, to coordinate with other stakeholders to ensure appropriate consistency at both the state and international levels as both of their proposals progress.

As Proposed, FSOC Should Enhance the Analytical Rigor and Transparency and Engagement with Primary Financial Regulators When Considering Making a Determination to Subject a Nonbank Financial Company to Supervision by the Federal Reserve

We are pleased that recent activities of the FSOC, including the decisions to rescind the nonbank SIFI designations on insurers, and the Proposed Guidance demonstrates a clear objective to address prior shortcomings of the designation process by leveraging the expertise of primary financial regulators, appropriately tailoring regulations to cost-effectively minimize burdens, requiring a cost-benefit analysis prior to making any designation, and ensuring the Council's designation analyses are rigorous and transparent.

We believe it's imperative for the FSOC to revise its interpretive guidance to codify certain existing practices as well as to implement new enhancements to its processes. Enhancing the analytical rigor and transparency, along with engagement with primary financial regulators, will greatly benefit regulators, industry and the public should the FSOC consider using its designation authority at some point in the future.

Prior to Proposed Guidance: Inconsistent Process as Applied to Different Sectors of the Financial Services Industry; Lack of Uniform, Consistent or Transparent Methodology

The FSOC process and use of authority has been extremely inconsistent as applied to different sectors of the financial services industry. This broad discrepancy in application of FSOC's authority is illustrated by the very different approaches taken towards different industries, without explanation.

The insurance industry has seen individual companies subject to scrutiny and designation, while for other industries, FSOC has focused on reviewing and identifying specific practices that may pose significant risk, or taken no action at all rather than singling out and designating specific firms.

Within the insurance sector itself, for past FSOC designation processes, there was no evidence of a uniform, consistent or transparent methodology being applied to each individual company under review. Life insurance companies that had gone through the designation process did not receive adequate information or explanation of FSOC analyses and decisions. The Council's past reliance upon implausible "run" scenario analysis for insurers lacked any historical basis and failed to acknowledge and appropriately consider the distinctions between banking and insurance sectors. Documents provided by FSOC to insurance companies offered few insights on the bases for designation decisions, costs as well as benefits of designation, or on pre or post designation off-ramps. These documents typically offered only conclusory statements, predictions, and speculations that are unsupported by factual and economic analysis or historical precedent. At the time, companies were not provided with enough information that would allow them to take positive steps to avoid designation or be de-designated through appropriate action.

Moreover, prior determinations failed to take into account the unique business of insurance. Specifically, the standard role of life insurers as long-term holders of assets and the counter-cyclical effect this has upon the broader economy were ignored. Additionally, prior analysis did not adequately consider consumers purchase insurance products for protection, long-term savings and a guarantee of lifetime income when it's time to retire, in other words, consumers are seeking long-term protection against risks and not for purposes of addressing potential short-term liquidity demands. A sector-wide view of potential systemic risk will better account for this and other risk-limiting factors.

The Role of Primary Financial Regulators

ACLI appreciates the reliance that the Proposed Guidance places on primary financial regulators throughout the document. We urge FSOC to take note that insurers residing within a savings and loan holding company (SLHC) are primarily regulated by state insurance regulators, as is the case with any other insurance company. Therefore, FSOC should afford the same deference to these regulators when considering any review or action regarding an insurer that is part of a SLHC.

Of particular concern with the FSOC process as applied to insurers had been its past failure to appropriately consider the role of existing primary financial regulators. This led to a lack of understanding and failure to recognize and seek to leverage the strong insurance regulatory framework in place through the state-based system, even though one of the explicit statutory requirements FSOC is directed to consider is the "degree to which the company is already regulated by one or more primary financial regulatory agencies." The state-based insurance regime has a long and successful track record of insurance regulation. In the past, and contrary to this statutory requirement, the FSOC has not appropriately considered the authority and tools available under the state-based insurance regime, including numerous and substantial reforms policymakers have implemented since the financial crisis. Failure to appropriately consider the role of existing primary financial regulators was another sign of the lack of due process in FSOC designation of individual insurers. This fundamental shortcoming was repeatedly highlighted by the voting member of FSOC with insurance expertise and nonvoting member of the state insurance commissioners.

In the Past, Application of the Material Financial Distress Standard Failed Basic Precepts of Accountability, Transparency and Consistency

The Dodd-Frank Act authorizes FSOC to designate a nonbank financial company for supervision by the Federal Reserve Board if either (1) material financial distress at the company, or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the company, could threaten the financial stability of the United States. Each of the initial designations made by FSOC had been based on the material financial distress standard alone. In each case, FSOC simply assumed the existence of material financial distress had or could occur at the company, and then concluded that such distress could be transmitted to the broader financial system.

We believe that past FSOC analysis used a flawed application of the material financial distress standard for designation. This led to distorting the purpose of designations by failing to account for the vulnerability of prospective designees and departing from the requirements of the Dodd-Frank Act and FSOC's own regulatory guidance.

ACLI is generally supportive of a cost-benefit analysis included in the determination process. We recommend the interpretive guidance extend the use of benefits and costs to the FSOC's activities-based approach. We also urge the development of some set of standards that provides clarity on how an ABA approach might transition to an EBA approach. As currently drafted, the two approaches seemingly co-exist with little indication as to how they interplay. A decision to transition from ABA to EBA would presumably come about only after extensive consultation with the company and its primary regulator. Greater detail for stakeholders to understand when and how a macroprudential risk needs to be addressed at the company level would be useful. This set of standards could include implementation costs and other inputs to measure a determination.

We Recommend FSOC Incorporate Insurance Specific Examples to Reflect Learnings Associated with Prior Analysis of Insurance Sector and Individual Firms

Although the FSOC has studied and assessed various nonbank financial sectors, the Council has devoted considerable resources, time and attention to the broader life insurance sector and specific insurers, including designating three insurers as nonbank SIFIs. Since its formation, the Council has also benefitted from the knowledge and expertise of Council members with insurance expertise, notably the independent member with insurance expertise, the NAIC representative designated by the state insurance commissioners, and the Federal Insurance Office. Council reports, academic research, government studies, commentaries and analyses on systemic risk and the insurance sector have also importantly contributed to the debate of perceived systemic risk of insurance companies and the sector. Collectively, these efforts have expanded and deepened the Council's understanding of insurance products and services, why consumers purchase insurance, the regulation of the insurance industry and highlighted critical flaws and shortcomings in prior assessments of systemic risk in the insurance sector.

While prior misguided assessments of systemic risk in the insurance sector as well as actions to designate insurers as nonbank SIFIs were detrimental to the sector and impacted firms, these experiences and others can and should serve as important reminders and lessons learned that will inform and guide the future of FSOC in fulfilling its statutory authorities.

To ensure these experiences are appropriately recognized and considered by the Council, we recommend the inclusion of examples that reflect unique considerations of the insurance industry. We recommend that considerations be incorporated into the interpretive guidance to recognize those attributes beyond contractual or statutory delay mechanisms that in general result in low liquidity risk for most insurance company product liabilities, including economic disincentives for the policyholder to surrender (such as loss of insurance and product guarantees, cost of obtaining new

coverage, and individual policyholder tax consequences) and the policyholder's purpose in acquiring the insurance product to meet financial security needs.

- First, recognize insurance separate accounts consist of funds held by a life insurance company, are maintained separately from the insurer's general account assets, and where the policyholder retains substantially all of the investment risk, such as when accessing liquidity from the policy. For example, the Council has acknowledged that with separate account products, the customer, not the insurer, retains most of the investment risk, and the insurer's equity and debt holders do not have a legal claim on separate account assets.
- Second, recognition of important mitigants and constrains to the potential fire sale of assets resulting from policyholder withdrawals or surrenders, which apply both to general account and separate account products. For example, policyholders purchase insurance for long-term financial protection and not for use as immediate sources of liquidity. Additionally, there are disincentives or limitations on early withdrawals and surrenders, including surrender charges, loss of contractual guarantees or insurance coverage, or tax penalties. This example would appropriately dispel the impossible "run on the insurer" scenario, such as a fire sale of assets to meet a liquidity demand, as well as reinforce the fact that policyholders purchase insurance to protect against future loss or assurance of long-term financial stability, not as a source of liquidity or discretionary funds.

Incorporating insurance-related examples will help illustrate important distinctions between banks and insurers, including the fact that consumers are purchasing insurance products for peace of mind protection such as to replace income in the event of an untimely death or provide a guaranteed stream of income in retirement, and not for purposes of demanding their money paid immediately.

With respect to life insurance companies, FSOC should look upon the liquidity assessment work being done by the National Association of Insurance Commissioners (NAIC). This work includes expanded reporting and liquidity stress testing.

We understand that much of the previous interpretive guidance related to potential determinations (and, specifically, the current six Stage 1 thresholds) will no longer be operative upon the finalization of this guidance. We do note, however, that certain elements of previous guidance material provided beneficial transparency as to the basis for FSOC analysis. One specific example is the Application of Accounting Standards set forth in the FSOC June 8, 2015 Methodologies Relating to Stage 1 Thresholds. This guidance importantly takes into account that some insurance companies report financial statements only under state statutory accounting principles (SAP). The guidance then describes adjustments that are made in order to make the SAP figures more comparable to US GAAP and thereby promote consistency and uniformity. This was beneficial in providing transparency to SAP-only insurers as to how the FSOC methodology would apply to them. Since Stage 1 thresholds are not envisioned going forward, this guidance will apparently no longer be directly needed. Yet we urge that it not be forgotten. And, should FSOC perform analysis of individual firms in the future we suggest that it be transparent about the methodologies being used.

Overbroad Guidance on "Nonbank Financial Company" to Include All Successors (Appendix A, Page 46)

Appendix "A" of the Proposed Guidance, page 46, provides additional insights on interpreting several key terms used in the Determination Standards, including "nonbank financial company." The

Appendix specifically states that: “In addition, the Council intends to interpret “nonbank financial company” as including any successor of a company that is subject to a final determination of the Council (emphasis added)”.

This interpretation is overly broad; under such an interpretation, affiliates or businesses comprising a portion of designated companies, to be spun off or sold as part of a nonbank financial company’s strategy to limit risk or to fund payments to creditors by way of example, could be designated companies. This designation would make the business or affiliate less valuable in light of the additional supervision and prudential standards applicable to companies under designation and could act as a “poison pill,” rendering any sale or other mergers and acquisitions-type transactions unviable.

Confidentiality of Designation Process

We specifically request that the Proposed Guidance’s discussion of the Two Stage evaluation process elaborate further on confidentiality (See, e.g., Appendix A, page 60, para “1”, lines “10-11”) by including a confirmation that: (1) The FSOC will pursue all legal and procedural steps to ensure that privileged, confidential and/or trade secret information shared with the Council by the nonbank financial company’s existing regulators or directly by the company will be treated as confidential and not be shared with parties other than the FSOC, the existing regulators and the company, and (2) This confidential treatment will be provided to all Council, regulator or company work product that incorporates such confidential information, including any written explanations or responses or challenges to proposed or final determinations or reevaluations.

These statements would encourage the necessary free flow of relevant qualitative and quantitative information from the nonbank financial company to the Council and its existing regulators. They also would support the extensive collaboration and engagement of the company, Council and existing regulators, and help ensure that the Council has the type and level of information in the evidentiary record needed to make a fair and appropriate assessment and, when designation is being considered, sufficient information for the FSOC to provide the company with clear guidance on pre and post designation off-ramps.

In closing, ACLI supports the Council’s stated intent behind the Proposed Guidance. This includes: (1) providing clearer and more transparent guidance to nonbank companies so that they can better understand and address the Council’s concerns regarding potential risks to financial stability, (2) ensuring the Council’s work is analytically rigorous by making procedural improvements to its processes, including streamlining the review and requiring a cost-benefit analysis, and (3) leveraging the knowledge and expertise of existing primary financial regulators, including state insurance commissioners. We believe that the Proposed Guidance moves the FSOC toward satisfying these goals, which are of critical importance to ACLI member companies and the families we support.

Thank you for the opportunity to comment, and please let me know if we can provide additional information.

Sincerely,



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