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Julie A. Spiezio
Senior Vice President, Insurance Regulation & Deputy General Counsel
(202) 624-2194 t (866) 953-4083 f
juliespiezio@acli.com

July 28, 2011

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., N.W.
Washington, D.C. 20551

The Honorable Martin Gruenberg
Acting Chairman, Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429

The Honorable John Walsh
Acting Comptroller of the Currency
Department of the Treasury
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219

RE: Proposed Guidance on Stress Testing for Banking Organizations With More than $10 Billion in Total Consolidated Assets (*Docket No. OP-1411; OCC-2011-0011*)

Dear Sirs:

These comments are submitted on behalf of the American Council of Life Insurers (the "ACLI"). The ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. On behalf of all our members, we appreciate the opportunity to submit comments on the proposed guidance (the "Proposed Guidance") referenced above as issued by the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Board"), and the Federal Deposit Insurance Corporation (the "FDIC") (collectively, the "Agencies"), and as published at 76 Federal Register 35072 (June 15, 2011).

The Proposed Guidance relates to stress testing practices at banking organizations with total consolidated assets of more than $10 billion. In the press release accompanying the Proposed Guidance, the Agencies indicate that building on previously issued guidance, the Proposed Guidance outlines general principles for a satisfactory stress testing framework, describes how stress testing should be used at various levels within an organization, and discusses the importance of stress testing in capital and liquidity planning.[1] In the press release, the Agencies also indicate that the Proposed Guidance does not explicitly address the stress testing requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), but that the Agencies

[1] Joint Press Release, Agencies Seek Comment on Stress Testing Guidance (June 9, 2011).

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anticipate that future rulemakings implementing the stress test requirements of the Dodd-Frank Act would be consistent with the principles in the Proposed Guidance.[2] The Agencies also indicate that they believe that it is important to establish the principles of stress testing as a background for these future rulemaking activities and supervisory initiatives.[3]

These comments suggest that the Proposed Guidance will form the basis not only for future supervisory initiatives but also for future rulemaking under the stress test provisions of the Dodd-Frank Act. The ACLI is offering its comments on the Proposed Guidance because of the implications that the Proposed Guidance holds for future rulemaking processes, although the breadth and scope of such future rulemaking is still undetermined. A number of ACLI member companies own insured depository institutions and thus may be subject to the Proposed Guidance, depending upon the intended scope of application of the Proposed Guidance, or to any future guidance or rulemaking. The predominant insurance nature of the ACLI member companies that own insured depository institutions provides an important perspective for commenting on the Proposed Guidance and any other future guidance or rulemaking on stress testing.

1. Clarification of Scope of Application of Proposed Guidance

The first comment of the ACLI relates to the intended scope of application of the Proposed Guidance. The Proposed Guidance states that it is applicable to "all [banking] institutions supervised by the agencies with more than $10 billion in total consolidated assets."[4] It further states that "[s]pecifically, with respect to the OCC, these banking institutions would include national banking associations and Federal branches and agencies [of foreign banks]; with respect to the Board, these banking organizations would include state member banks, bank holding companies, and all other institutions for which the Federal Reserve is the primary federal supervisor; with respect to the FDIC, these banking organizations would include state nonmember insured banks or insured branches of foreign banks."[5] No mention is made of savings associations or savings and loan holding companies in the Proposed Guidance, presumably because the Proposed Guidance was issued in advance of July 21, 2011, the date of transfer of supervisory responsibility for these entities from the Office of Thrift Supervision to the respective Agencies. Accordingly, the ACLI assumes that the Proposed Guidance is not intended to apply to savings associations or savings and loan holding companies. The ACLI requests that when the Agencies adopt the Proposed Guideline in final form, they confirm that it does not apply to savings associations or savings and loan holding companies. The ACLI further assumes that if the Agencies determine in the future that they wish to propose guidance with respect to stress testing for these entities, the Agencies will issue any such proposed guidance with a separate opportunity for comment by all interested parties. For the reasons discussed below, the ACLI believes if the Agencies should determine to issue any such proposed guidance, the proposed guidance should be specifically tailored to the situation of savings and loan holding companies, such as those predominantly engaged in the insurance business, that differs significantly both in business model and risk profile from the situation of banking organizations.

2. Potential Future Application to Savings and Loan Holding Companies

As the ACLI has noted in its comments on the Board's Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, the Board is at the outset of a

[2] Id. It is our expectation that such future rulemaking will provide the opportunity for additional comments from interested parties.
[3] Id.
[4] 76 Fed. Reg. at 35077.
[5] 76 Fed. Reg. at 35077-35078.

process of developing a supervisory approach to savings and loan holding companies.[6] In designing an overall supervisory approach, rather than beginning with the presumption that various elements of the supervisory approach developed and used for bank holding companies or other banking entities should apply to savings and loan holding companies, the Board should instead begin by considering the differentiating characteristics of savings and loan holding companies, particularly those that are predominantly insurance enterprises, and then tailor a supervisory approach to the actual business models and risk characteristics of the entity. This basic principle should apply to any aspect of future supervision of savings and loan holding companies because of the diversity of activities of savings and loan holding companies and the relatively small weight of depository institution activities compared to the total consolidated activities of many large savings and loan holding companies. This principle is particularly important in the case of savings and loan holding companies that are predominantly insurance enterprises because any supervisory approach designed by the Board must also take full account of the longstanding and comprehensive regulatory and supervisory system established by state insurance law and implemented by state insurance authorities.

The Proposed Guidance provides an example of this principle if the Board should decide in the future that it wishes to propose guidance on stress testing for savings and loan holding companies. As the discussion in the Supplemental Information section of the Federal Register notice indicates, the Proposed Guidance is based on previous experience by the Agencies in applying stress tests to various operations of banking organizations.[7] As the Agencies further note, the Proposed Guidance "is intended to be consistent with industry practices," [8] meaning banking industry practices. It is entirely understandable that the Agencies would base a new guidance document intended for application to banking organizations on their prior supervisory experience with banking organizations and on banking industry practices. However, it would be inappropriate to assume that either past regulatory experience with bank organizations or banking industry practices provide a basis for applying the same guidance to savings and loan holding companies, particularly those that are predominantly engaged in insurance activities.

To the contrary, the development of the Proposed Guidance based on the Agencies' prior regulatory experience with banking organizations and on banking industry practices supports the principle that the Agencies should base any future guidance applicable to savings and loan holding companies on regulatory experience with such entities and applicable industry practices, especially insurance industry practices. The Board has a long and detailed knowledge of the banking industry. The Board is in the early stages of developing a detailed working knowledge of the insurance industry. The ACLI wishes to offer its assistance in facilitating the Board's access to information on insurance industry risk management practices and insurance regulatory requirements as the Board considers how it should implement its supervisory approach to such insurance entities.[9]

Ultimately, familiarity with the industry must provide the basis for the development of any supervisory approach, including stress testing, particularly if the stress testing is in practice to be a useful exercise either for the Agencies or the regulated entities. At some level of generality, principles of stress testing can be made applicable to virtually any entity. But the functionality of stress testing will be highly dependent upon the business risks and other characteristics of the tested

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[6] ACLI Letter to Hon. Ben S. Bernanke (May 20, 2011).

[7] 76 Fed. Reg. at 35073 n.2 (providing an extensive list of prior stress test related guidance issued by the Agencies with respect to the operations of banking organizations).

[8] 76 Fed. Reg. at 35073.

[9] The ACLI also wishes to offer its assistance in facilitating the Board's access to information on insurance industry risks management practices and insurance regulatory requirements in connection with the process for determining whether insurance companies should be considered for designation under section 113 of the Dodd-Frank Act.

entity. This requires tailoring of the stress test approach to the type of industry entity involved. High level principles for stress testing devoid of practical knowledge of the industry will not provide the kind of "actionable" results that the Proposed Guidance itself strives to achieve.

3. Additional Suggestions for Any Future Guidance

The Proposed Guidance indicates that stress testing should be applied at various levels in a banking organization, such as business line, portfolio and risk type, as well as on an enterprise-wide basis. The Proposed Guidance also indicates that a prominent part of stress testing for banking organizations, particularly at the enterprise-wide level, is an assessment of the adequacy of capital and liquidity. The Proposed Guidance expressly builds upon the extensive supervisory guidance previously issued by the Agencies relating to capital and liquidity management for banking organizations. As part of any future guidance or rulemaking that the Board may undertake for savings and loan holding companies, the Board must recognize that significantly different capital and liquidity considerations apply to savings and loan holding companies that are predominantly insurance enterprises than to banking organizations.[10]

As noted in a 2002 joint report issued by the staff of the Board and the National Association of Insurance Commissioners (NAIC), the capital frameworks applicable to banking organizations and insurance organizations "differ fundamentally in the risks they are designed to assess, as well as in their treatments of certain risks that might appear to be common to both sectors."[11] The report further observes: "As a result, the effective regulatory capital requirements for assets, liabilities, and various business risks for insurers are not the same as those for banks."[12] As the joint report generally notes, the differing capital approaches reflect the inherent differences between the insurance and banking industries themselves. Any proposed supervisory approach to stress testing for savings and loan holding companies that are predominantly insurance organizations must also proceed from these foundational observations. Stress testing for insurance organizations must be based *inter alia* on the recognition of the different nature and duration of risks that insurance companies encounter, particularly on their liability side, than banking organizations encounter. The different nature and duration of the risks for insurance companies necessarily translate into different capital and liquidity considerations.

The inherent differences between the insurance industry and the banking industry will also affect the approaches to stress testing more generally. Although they are infrequent, past life insurer insolvencies were generally the result of a failure to properly match assets and liabilities. As a result, state insurance regulators have developed a strong regulatory framework to ensure and demonstrate proper asset/liability matching. The ACLI suggests that the Board consider incorporating reliance on these and other aspects of state insurance regulation into any supervisory model that the Board may consider for savings and loan holding companies that are predominantly insurance enterprises. This will allow the Board to leverage its supervisory approach (both from a time and expertise perspective) off the very substantial supervisory experience that the state insurance regulators already have with their regulated insurance entities. This approach is also consistent with the directives in section 604(g) and (h) of the Dodd-Frank Act that the Board should

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[10] Although savings and loan holding companies that are predominantly insurance enterprises are the focus of this discussion, these comments are also relevant to application of the proposed guidance to any entity that is predominantly and insurance company, including a bank holding company or a nonbank financial company under sec. 113 of the Dodd-Frank Act.

[11] Report of the National Association of Insurance Commissioners (NAIC) and the Federal Reserve System Joint Subgroup on Risk-Based Capital and Regulatory Arbitrage (May 24, 2002) at 1.

[12] Id.

to the fullest extent possible use supervisory information that a savings and loan holding company or subsidiary is required to provide to state regulatory agencies and avoid duplication of reporting requirements or requests for information.

4. Comments on Specific Provisions of the Guidance

In addition to our comments regarding the contemplated scope of the guidance, we have several concerns regarding the specific provisions of the guidance.

First, we are concerned about the potential for examiners to criticize individual or isolated stress test results. Large multi-faceted organizations will undoubtedly complete a sizeable number of stress tests annually to test liquidity, capital, and credit quality. The guidance may further an environment in which examiners feel justified to criticize any failure to protect against the risk assumed in each and every test. Such an approach unduly intrudes into the business judgment properly exercised by company's management. Individual stress test results must properly be considered as a part of a larger risk management program designed to present an overview of potential risks faced by an institution. We ask that the guidance be clarified to appropriately note that it is not the agencies intention to support supervisory criticism based on individual stress test results without placing the results in the proper context within a larger risk management structure and business plan.

Second, stress testing is a tool for management and the board to manage risk; the more extreme and unrealistic the scenarios used in the testing regime, the less useful the overall stress testing protocol. The required use of unrealistic scenarios is not an appropriate objective of the guidance and we ask that the agencies clarify that such scenarios are not required to be used.

Third, stress testing ought not to be used to challenge conventional assumptions underlying an organization's business model. Depending on the circumstances of a specific business plan, stress test results may either understate the risk to be disclosed or overstate the nature and extent of the risk to be disclosed. The guidance should clearly note the extent and nature of the role that an individual organization's judgment plays in assessing the results of, and developing appropriate responses to, stress tests.

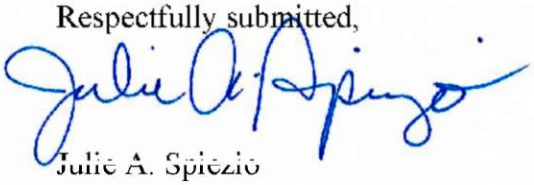
Fourth, the guidance provides that senior management should report regularly to the organization's board of directors on stress testing developments and results from individual and collective stress tests, and on compliance with stress testing policy. The guidance expectation is that board members will evaluate and discuss these reports. In our judgment, the appropriate role of the board is to provide direction and oversight to ensure an effective stress testing program. However, operation and implementation of the program remain the responsibility of senior management. An expectation that individual stress test results will be reported to and evaluated by the board requires the board to assume an operational and implementation role in connection with the program. This extends beyond the board's traditional and appropriate function of providing strategic direction and program oversight. Stress test results are appropriately taken into account in the board's strategic planning and the successful nature of implementation of the program should be considered when evaluating the effectiveness of management. But boards should not be placed in the role of operation and implementation of the program details. Boards have an important role to play in risk management, but that role is appropriately limited to ensuring the appropriate breadth and design of the stress testing program, approving its initial establishment and annually monitoring its effectiveness.

Finally, the guidance commentary estimates that the average information collection burden imposed by the guidance would be 260 hours a year. We believe that number is unrelated to any fair

evaluation of the work involved in the collection of data and implementation of stress test programming. If it is intended to cover only the data collection portion of the proposal, the time estimate is meaningless and misrepresents the true nature of the institutional commitment to the stress testing envisioned by the guidance. Even a smaller organization seeking to meet the guidance will require a significant multiple of the time commitment suggested by the guidance. That is the case even without taking into account the time associated with expected board review, independent validation of the models or the additional granularity expected by the guidance and examiners and the resulting need to further refine the program and its testing protocol. We suggest that the guidance time estimates were published without sufficient input from those institutions affected by the guidance. We urge the agencies to recognize the far greater resource commitment required to meet the guidance and, in doing so, to consult with those institutions subject to the guidance to develop a better estimate of actual resource and time needs. When coupled with the myriad of additional regulations faced by the same set of institutions, it is important for the agencies to recognize and respond to the substantial additional regulatory burden placed on these companies. The agencies cannot do so unless they realistically monitor the projected time commitments associated with each new regulatory burden added to the already substantial regulatory time commitment.

Thank you for your consideration of our views. We are available for further discussion on this matter at your convenience.

Respectfully submitted,



Julie A. Spiezio

CC: Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429