

# Proposed Rules

Federal Register

Vol. 81, No. 114

Tuesday, June 14, 2016

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

Issued in Washington, DC, on June 8, 2016.

**Bill McArthur,**

*Acting Director, Office of Health and Safety.*

[FR Doc. 2016-14020 Filed 6-13-16; 8:45 am]

**BILLING CODE 6450-01-P**

## DEPARTMENT OF ENERGY

### 10 CFR Part 850

[Docket No. AU-RM-11-CBDPP]

RIN 1992-AA39

#### Chronic Beryllium Disease Prevention Program; Correction

**AGENCY:** Office of Environment, Health, Safety and Security, U.S. Department of Energy.

**ACTION:** Notice of proposed rulemaking and public hearings; correction.

**SUMMARY:** This document corrects the ADDRESSES section to the notice of proposed rulemaking and public hearings which published in the *Federal Register* on June 7, 2016, regarding the Chronic Beryllium Disease Prevention Program. This correction revises the addresses relating to two of the public hearings.

**DATES:** June 14, 2016.

**FOR FURTHER INFORMATION CONTACT:** Jacqueline D. Rogers, 202-586-4714, email: [jackie.rogers@hq.doe.gov](mailto:jackie.rogers@hq.doe.gov), or Meredith Harris, 301-903-6061, email: [meredith.harris@hq.doe.gov](mailto:meredith.harris@hq.doe.gov).

#### SUPPLEMENTARY INFORMATION:

##### Correction

In proposed rule document FR 2016-12547 appearing on page 36704, in the issue of Tuesday, June 7, 2016, (81 FR 36704), the following corrections should be made:

On page 36704, in the second column, the next to the last paragraph in the ADDRESSES section is corrected to the following:

1. Richland, WA: HAMMER Federal Training Facility, State Department Room, 2890 Horn Rapids Road, Richland, WA 99354;

On page 36704, in the third column, the first paragraph in the ADDRESSES section is corrected to the following:

3. Las Vegas, NV: North Las Vegas Facility, 2621 Losee Road, Building C1, Auditorium, North Las Vegas, NV 89030-4129.

## FEDERAL RESERVE SYSTEM

### 12 CFR Part 252

[Docket No. R-1540; Regulation YY]

RIN 7100 AE 54

#### Enhanced Prudential Standards for Systemically Important Insurance Companies

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Request for public comment on the application of enhanced prudential standards to certain nonbank financial companies.

**SUMMARY:** Pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Board of Governors of the Federal Reserve System is inviting public comment on the proposed application of enhanced prudential standards to certain nonbank financial companies that the Financial Stability Oversight Council has determined should be supervised by the Board. The Board is proposing corporate governance, risk-management, and liquidity risk-management standards that are tailored to the business models, capital structures, risk profiles, and systemic footprints of the nonbank financial companies with significant insurance activities.

**DATES:** Comments must be submitted by August 17, 2016.

**ADDRESSES:** You may submit comments, identified by Docket No. R-1540, RIN 7100 AE 54, by any of the following methods:

*Agency Web site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

*Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

*Email:* [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include docket R-1540, RIN 7100 AE 54 in the subject line of the message.

*FAX:* (202) 452-3819 or (202) 452-3102.

*Mail:* Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room 3515, 1801 K Street NW., (between 18th and 19th Streets), Washington, DC 20551 between 9:00 a.m. and 5:00 p.m. on weekdays.

**FOR FURTHER INFORMATION CONTACT:** Thomas Sullivan, Associate Director, (202) 475-7656, Linda Duzick, Manager, (202) 728-5881, Noah Cuttler, Senior Financial Analyst, (202) 912-4678, or Matt Walker, Senior Analyst & Insurance Team Project Manager, (202) 872-4971, Division of Banking Supervision and Regulation; or Laurie Schaffer, Associate General Counsel, (202) 452-2272, Tate Wilson, Counsel, (202) 452-3696, or Steve Bowne, Senior Attorney, (202) 452-3900, Legal Division.

#### SUPPLEMENTARY INFORMATION:

##### I. Introduction

Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directs the Board of Governors of the Federal Reserve System (Board) to establish enhanced prudential standards for nonbank financial companies that the Financial Stability Oversight Council (Council) has determined should be supervised by the Board and bank holding companies with total consolidated assets equal to or greater than \$50 billion in order to prevent or mitigate risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities, of these companies.<sup>1</sup> The enhanced prudential standards must include risk-based capital requirements and leverage limits, liquidity requirements, certain risk-management requirements, resolution-planning requirements, single-counterparty credit limits, and stress-test requirements. Section 165 also permits the Board to establish

<sup>1</sup> 12 U.S.C. 5365.

additional enhanced prudential standards, including a contingent capital requirement, an enhanced public disclosure requirement, a short-term debt limit, and any other prudential standards that the Board determines are appropriate.

In prescribing enhanced prudential standards, section 165(a)(2) of the Dodd-Frank Act permits the Board to tailor the enhanced prudential standards among companies on an individual basis, taking into consideration their “capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board . . . deems appropriate.”<sup>2</sup> In addition, under

section 165(b)(3) of the Dodd-Frank Act, the Board is required to take into account differences among bank holding companies covered by section 165 of the Dodd-Frank Act and nonbank financial companies supervised by the Board, based on statutory considerations.<sup>3</sup>

The factors the Board must consider include: (1) The factors described in sections 113(a) and (b) of the Dodd-Frank Act (12 U.S.C. 5313(a) and (b)); (2) whether the companies own an insured depository institution; (3) nonfinancial activities and affiliations of the companies; and (4) any other risk-related factors that the Board determines appropriate.<sup>4</sup> The Board must, as appropriate, adapt the required standards in light of any predominant line of business of nonbank financial companies, including activities for which particular standards may not be appropriate.<sup>5</sup> Section 165(b)(3) of the Dodd-Frank Act also requires the Board, to the extent possible, to ensure that small changes in the factors listed in sections 113(a) and 113(b) of the Dodd-Frank Act would not result in sharp, discontinuous changes in the enhanced prudential standards established by the Board under section 165(b)(1) of the Dodd-Frank Act.<sup>6</sup> The statute also directs the Board to take into account any recommendations made by the Council pursuant to its authority under section 115 of the Dodd-Frank Act.<sup>7</sup>

For bank holding companies with total consolidated assets equal to or greater than \$50 billion and certain foreign banking organizations, the Board has issued an integrated set of enhanced prudential standards through a series of rulemakings, including the Board’s

capital plan rule,<sup>8</sup> stress-testing rules,<sup>9</sup> resolution plan rule,<sup>10</sup> and the Board’s enhanced prudential standards rule under Regulation YY.<sup>11</sup> As part of the integrated enhanced prudential standards applicable to the largest, most complex bank holding companies, the Board also adopted enhanced liquidity requirements through the liquidity coverage ratio rule and adopted enhanced leverage capital requirements through a supplementary leverage ratio. Further, the Board issued risk-based capital charges and an enhanced supplementary leverage ratio for the most systemic bank holding companies.<sup>12</sup> In addition, through a final order the Board established enhanced prudential standards for General Electric Capital Corporation, a nonbank financial company designated by the Council for supervision by the Board.<sup>13</sup> In the preamble accompanying the final enhanced prudential standards regulation for bank holding companies, the Board stated its intent to assess thoroughly the business model, capital structure, and risk profile of each company in considering the application of enhanced prudential standards to nonbank financial companies designated by the Council, consistent with the Dodd-Frank Act.<sup>14</sup>

The Board invites public comment on the application of corporate governance and risk-management and liquidity risk-management standards to certain insurance-focused nonbank financial companies that the Council determined should be subject to Board supervision.<sup>15</sup> Specifically, the enhanced prudential standards would apply to any nonbank financial company that meets two requirements: (1) The Council has determined pursuant to section 113 of the Dodd-Frank Act that the company should be supervised by the Board and subjected to enhanced prudential standards, and (2) the company has 40 percent or more of its total consolidated assets related to insurance activities as of the end of either of the two most recently completed fiscal years (systemically important insurance companies) or

otherwise has been made subject to these requirements by the Board. As of the date of publication of this document in the **Federal Register**, American International Group, Inc. (AIG), and Prudential Financial, Inc. (Prudential), would be required to comply with the proposed enhanced prudential standards, if adopted as proposed.<sup>16</sup>

The corporate governance and risk-management standard would build on the core provisions of the Board’s SR letter 12–17, Consolidated Supervision Framework for Large Financial Institutions.<sup>17</sup> The proposed liquidity risk-management requirements would help mitigate liquidity risks at systemically important insurance companies. The proposal would tailor these standards to account for the differences in business models, capital structure, risk profiles, existing supervisory framework, and systemic footprints between bank holding companies and systemically important insurance companies.

The Board believes that it is appropriate to seek public comment on the application of the proposed standards in order to provide transparency regarding the regulation and supervision of systemically important insurance companies. The public comment process will provide systemically important insurance companies supervised by the Board and interested members of the public with the opportunity to comment and will help guide the Board in future application of enhanced prudential standards to other nonbank financial companies.

*Question 1: The Board invites comment on all aspects of the proposed rule, including in particular the aspects noted in more detailed questions at the end of each section.*

*Question 2: The Board invites comment on the 40 percent threshold contained in the proposed definition of systemically important insurance company. Would an alternative measure be more appropriate? Why or why not?*

## II. Corporate Governance and Risk-Management Standard

### A. Background

During the preceding decades and the recent financial crisis in particular, a number of insurers that experienced material financial distress had

<sup>16</sup> As noted above, General Electric Capital Corporation is already subject by Board order to certain enhanced prudential standards.

<sup>17</sup> Supervision and Regulation Letter 12–17/ Consumer Affairs Letter 12–14 (December 17, 2012), available at <https://www.federalreserve.gov/bankinfo/srletters/sr1217.htm>.

<sup>8</sup> 12 CFR 225.8.

<sup>9</sup> See 12 CFR part 252.

<sup>10</sup> 12 CFR part 243.

<sup>11</sup> See 79 FR 17420 (March 27, 2014).

<sup>12</sup> 12 CFR 217.11(c).

<sup>13</sup> 80 FR 142 (July 24, 2015).

<sup>14</sup> See 79 FR 17240, 17245 (March 27, 2014).

<sup>15</sup> The Board intends to consider enhanced risk-based capital and leverage requirements, liquidity requirements, single-counterparty credit limits, a debt-to-equity limit, and stress testing requirements at a later date. In addition, the Board has issued a resolution plan rule that by its terms applies to all nonbank financial companies supervised by the Board.

<sup>2</sup> 12 U.S.C. 5365(a)(2).

<sup>3</sup> See 12 U.S.C. 5365(b)(3).

<sup>4</sup> 12 U.S.C. 5365(b)(3)(A).

<sup>5</sup> 12 U.S.C. 5365(b)(3)(D).

<sup>6</sup> 12 U.S.C. 5365(b)(3)(B).

<sup>7</sup> 12 U.S.C. 5365(b)(3)(C).

significant deficiencies in key areas of corporate governance and risk management.<sup>18</sup> Effective enterprise-wide risk management by large, interconnected financial companies promotes financial stability by reducing the likelihood of a large, interconnected financial company's material distress or failure. An enterprise-wide approach to risk management would allow systemically important insurance companies to appropriately identify, measure, monitor, and control risk throughout their entire organizations, including risks that may arise from intragroup transactions, unregulated entities, or centralized material operations that would not be subject to review at the legal entity level.

Accordingly, the Board is proposing to apply to systemically important insurance companies an enhanced corporate governance and risk-management standard that would build on the core provisions of SR 12-17, the Board's consolidated supervision framework for large financial institutions.<sup>19</sup> These standards would be applied, however, in a manner that is tailored to account for the business model, capital structure, risk profile, and activities of financial firms that are largely engaged in insurance (rather than banking) activities. Specifically, the proposal creates responsibilities for a systemically important insurance company's risk committee, chief risk officer, and chief actuary.

#### *B. Risk Committee and Risk-Management Framework*

Consistent with section 165(h)(1) of the Dodd-Frank Act, the proposed rule would require a systemically important insurance company to maintain a risk committee that approves and periodically reviews the risk-management policies of the company's global operations and oversees the operation of the company's global risk-management framework.<sup>20</sup> A large,

interconnected financial institution's risk committee, acting in its oversight role, should fully understand the institution's corporate governance and risk-management framework and have a general understanding of its risk-management practices.

The proposal would also require that the risk committee oversee the systemically important insurance company's enterprise-wide risk-management framework, and that this framework be commensurate with the systemically important insurance company's structure, risk profile, complexity, activities, and size. An enterprise-wide risk-management framework facilitates management of and creates accountability for risks that reside in different geographic areas and lines of business. The risk-management framework would be required to include policies and procedures for establishing risk-management governance and procedures and risk-control infrastructure for the company's global operations. To implement and monitor compliance with these policies and procedures, the proposal would require the company to have processes and systems that (1) have mechanisms to identify and report risks and risk-management deficiencies, including emerging risks, and ensure effective and timely implementation of actions to address such risks and deficiencies; (2) establish managerial and employee responsibility for risk management; (3) ensure the independence of the risk-management function; and (4) integrate controls with management goals and its compensation structure for its global operations.

A systemically important insurance company's risk-management framework would be strengthened by having an appropriate level of stature within its overall corporate governance framework. Accordingly, the proposal would provide that a systemically important insurance company's risk committee be an independent committee of the company's board of directors and have, as its sole and exclusive function, responsibility for the risk-management policies of the company's global operations and oversight of the operation of the company's global risk-management framework. The risk committee would be required to report directly to the systemically important insurance company's board of directors and would receive and review regular reports on not less than a quarterly basis from the company's chief risk officer. In addition, the risk committee would be required to meet at least quarterly, fully document

and maintain records of its proceedings, and have a formal, written charter that is approved by the systemically important insurance company's board of directors.

Consistent with section 165(h)(3)(C) of the Dodd-Frank Act, the proposal would require that the risk committee include at least one member with experience in identifying, assessing, and managing risk exposures of large, complex financial firms.<sup>21</sup> For this purpose, a financial firm would include an insurance company, a securities broker-dealer, or a bank. The individual's experience in risk management would be expected to be commensurate with the company's structure, risk profile, complexity, activities, and size, and the company would be expected to demonstrate that the individual's experience is relevant to the particular risks facing the company. While the proposal would require that only one member of the risk committee have experience in identifying, assessing, and managing risk exposures of large, complex firms, all risk committee members should have a general understanding of risk-management principles and practices relevant to the company.

Consistent with section 165(h)(3)(B) of the Dodd-Frank Act, the proposed rule also would include certain requirements to ensure that the chair of the risk committee has sufficient independence from the systemically important insurance company.<sup>22</sup> The proposal would require that the chair of the risk committee (1) not be an officer or employee of the company nor have been one during the previous three years; (2) not be a member of the immediate family of a person who is, or has been within the last three years, an executive officer of the company; and (3) meet the requirements for an independent director under Item 407 of the Securities and Exchange Commission's (SEC) Regulation S-K, or must qualify as an independent director under the listing standards of a national securities exchange, as demonstrated to the satisfaction of the Board, if the company does not have an outstanding class of securities traded on a national securities exchange.

The Board views the active involvement of independent directors as vital to robust oversight of risk management and encourages companies

<sup>18</sup> See Standard and Poor's Ratings Services, "What May Cause Insurance Companies to Fail and How This Influences Our Criteria" (June 2013), at 11-13; see also U.S. House of Representatives, "Failed Promises: Insurance Company Insolvencies" (1990); Financial Crisis Inquiry Commission, "Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States" (January 2011), pg. 352, available at [http://fcic-static.law.stanford.edu/cdn\\_media/fcic-reports/fcic\\_final\\_report\\_full.pdf](http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).

<sup>19</sup> SR 12-17 sets forth a framework for the consolidated supervision of large financial institutions, and has two primary objectives: (1) Enhancing resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary, and (2) reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness.

<sup>20</sup> 12 U.S.C. 5365(h)(1).

<sup>21</sup> See 12 U.S.C. 5365(h)(3)(C).

<sup>22</sup> See 12 U.S.C. 5365(h)(3)(B).

<sup>23</sup> For purposes of this requirement, "immediate family" would be defined pursuant to the Board's Regulation Y, 12 CFR 225.41(b)(3), and "executive officer" would be defined pursuant to the Board's Regulation O, 12 CFR 215.2(e)(1).

generally to include additional independent directors as members of their risk committees. However, the Board notes that not all members of the risk committee would be required to be independent, and involvement of directors affiliated with the company on the risk committee could complement the involvement of independent directors.

*Question 3: Are there additional qualifications and experience that the Board should require of a member or members of the risk committee of a systemically important insurance company?*

*Question 4: The Board invites comment on whether the structure of the risk committee and the duties proposed to be assigned to the risk committee are appropriate.*

### C. Chief Risk Officer and Chief Actuary

Most large, interconnected financial institutions, including large insurance companies, designate a chief risk officer to facilitate an enterprise-wide approach to the identification and management of all risks within an organization, regardless of where they are originated or housed. The chief risk officer supplements the work of legal entity, risk level (e.g., credit or operational risk), and line of business risk-management activities by identifying, measuring, and monitoring risks that may exist intentionally or unintentionally. The proposed rule would require each systemically important insurance company to have a chief risk officer and describes the minimum responsibilities of the chief risk officer. Under the proposal, the chief risk officer's function would extend to all risks facing the systemically important insurance company, including risks from non-insurance activities and insurance activities, such as risks arising out of unanticipated increases in reserves.

The proposal provides that the chief risk officer would be responsible for overseeing (1) the establishment of risk limits on an enterprise-wide basis and monitoring compliance with such limits; (2) the implementation of and ongoing compliance with the policies and procedures establishing risk-management governance and the development and implementation of the processes and systems related to the global risk-management framework; and (3) management of risks and risk controls within the parameters of the company's risk control framework, and monitoring and testing of such risk controls. The chief risk officer also would be responsible for reporting risk-

management deficiencies and emerging risks to the risk committee.

The proposal would require the chief risk officer to have experience in identifying, assessing, and managing risk exposures of large, complex financial firms. The minimum qualifications for a chief risk officer would be similar to the risk-management experience requirement that at least one member of the company's risk committee must meet. The proposal was designed with the expectation that a systemically important insurance company would be able to demonstrate that its chief risk officer's experience is relevant to the particular risks facing the company and is commensurate with the company's structure, risk profile, complexity, activities, and size.

The proposed standard would also require systemically important insurance companies to have a chief actuary to ensure an enterprise-wide view of reserve adequacy across legal entities, lines of business, and geographic boundaries. Inadequate reserving is a common cause of insurer insolvencies.<sup>24</sup> Insurance companies have complex balance sheets that depend heavily on estimates concerning the amount and timing of payments. Actuaries at insurance companies serve a critical role by developing these estimates and providing other technical insights on risk and financial performance. The estimates and the related processes, methodologies, and documentation can vary across jurisdictions and lines of businesses. The systemically important insurance companies have numerous insurance company subsidiaries and lines of businesses with their own actuarial functions. The organization may not have, however, an actuarial role or roles with the appropriate amount of stature and independence from the lines of business and legal entities.

The chief actuary would be responsible for advising the chief executive officer and other members of senior management and the board's audit committee on the level of reserves. Under the proposed rule, the chief actuary would also have oversight responsibilities over (1) implementation of measures that assess the sufficiency of reserves; (2) review of the appropriateness of actuarial models, data, and assumptions used in reserving; and (3) implementation of

and compliance with appropriate policies and procedures relating to actuarial work in reserving. The chief actuary would be required to ensure that the company's actuarial units perform in accordance with an articulated set of standards that govern process, methodologies, data, and documentation; comply with applicable jurisdictional regulations; and adhere to the relevant codes of actuarial conduct and practice standards. The proposed rule would permit the chief actuary to have additional responsibilities, including overseeing ratemaking for insurance products.

If a systemically important insurance company has significant amounts of life insurance and property and casualty insurance business, the proposal would allow systemically important insurance companies to have co-chief actuaries—one responsible for the company's life business and one responsible for the company's property and casualty business. Within the United States, the two different businesses have historically had separate professional organizations and correspondingly different professional examination requirements to obtain actuarial credentials. The actuarial techniques used in these two businesses starkly differ. While a single position with an enterprise-wide view of reserve adequacy is desirable, the Board recognizes that the need for chief actuaries to have the expertise necessary to carry out their duties. Thus, the proposed rule would permit, but not require, a systemically important insurance company to appoint a chief actuary with enterprise-wide responsibility for the life insurance activities and a separate chief actuary with enterprise-wide responsibility for the property and casualty insurance activities.

Under the proposed rule, the chief actuary would be expected to have experience that is relevant to the functions performed and commensurate with the company's structure, risk profile, complexity, activities, and size. This background should allow the chief actuary to discuss reserve adequacy with executive management and to communicate on actual practices and techniques with the underwriting, claims, legal, treasury, and other departments.

Under the proposed rule, the chief risk officer and chief actuary would be required to maintain a level of independence. In addition to other lines of reporting, the chief risk officer and chief actuary would be required to report directly to their board's risk committee and audit committee,

<sup>24</sup> See Standard and Poor's Ratings Services, "What May Cause Insurance Companies to Fail and How this Influences Our Criteria" (June 2013), pg. 8–10; see also U.S. House of Representatives, "Failed Promises: Insurance Company Insolvencies" (1990).

respectively. Requiring the chief risk officer and chief actuary to report directly to board committees provides stature and independence from the lines of businesses and legal entities, which facilitates unbiased insurance risk assessment and estimation of insurance reserves. Furthermore, the proposal would not allow the chief risk officer and chief actuary roles to be performed by the same person because the positions serve distinct and separate independent oversight functions within the company. This separation would allow the risk group to review and challenge the actuarial assumptions used to prepare financial statements and provide an extra line of defense against improper reserving.

In addition, the proposal would require a systemically important insurance company to ensure that the compensation and other incentives provided to the chief risk officer and chief actuary are consistent with their functions of providing objective assessments of a company's risks and actuarial estimates. This requirement would supplement existing Board guidance on incentive compensation, which provides, among other things, that compensation for employees in risk-management and control functions should avoid conflicts of interest and that incentive compensation received by these employees should not be based substantially on the financial performance of the business units that they review.<sup>25</sup> In addition, the proposed requirement would allow systemically important insurance companies wide discretion to adopt compensation structures for chief risk officers and chief actuaries, whether through a compensation committee or otherwise, as long as the structure of their compensation allows them to objectively assess risk and does not create improper incentives to take inappropriate risks.

*Question 5: Are the responsibilities and requirements for the chief risk officer and the chief actuary of a systemically important insurance company appropriate? What additional responsibilities and requirements should the Board consider imposing?*

*Question 6: Should the Board require a single, enterprise-wide chief actuary instead of allowing the position to be split between life and property and casualty operations? Why or why not?*

<sup>25</sup> See Guidance on Sound Incentive Compensation Policies, 75 FR 36395 (June 25, 2010).

### III. Liquidity Risk-Management Standard

#### A. Background

The activities and liabilities of systemically important insurance companies generate liquidity risk. The financial crisis that began in 2007 demonstrated that liquidity can evaporate quickly and cause severe stress in the financial markets. In some cases, financial companies had difficulty in meeting their obligations as they became due because sources of funding became severely restricted. The financial crisis and past insurance failures also demonstrate that even solvent insurers may experience material financial distress, including failure, if they do not manage their liquidity in a prudent manner.<sup>26</sup> Although many of a systemically important insurance company's liabilities are long-term or contingent upon the occurrence of a future event, such as the death of the insured or destruction of insured property, certain insurance contracts are subject to surrender or withdrawal with little or no penalty and on short notice and may create significant unanticipated demands for liquidity. Additionally, some activities and liabilities such as securities lending, issuance of some forms of funding agreements, collateral calls on derivatives used for hedging, and other sources can create liquidity needs during stress. For systemically important insurance companies, the negative effects of their material financial distress from a liquidity shortage could be transmitted to the broader economy through the sale of financial assets in a manner that could disrupt the functioning of key markets or cause significant losses or funding problems at other firms with similar holdings.

The proposal would require that a systemically important insurance company implement a number of provisions to manage its liquidity risk. For purposes of the proposed rule, liquidity is defined as a systemically important insurance company's capacity to meet efficiently its expected and unexpected cash flows and collateral needs at a reasonable cost without adversely affecting the daily operations or the financial condition of the systemically important insurance

<sup>26</sup> See U.S. Govt. Accountability Office, GAO-13-583, "Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis," June 2013, at 10-16, 46-48, available at <http://gao.gov/assets/660/655612.pdf>. See also Standard and Poor's Ratings Services, "What May Cause Insurance Companies to Fail and How this Influences Our Criteria" (June 2013).

company. Under the proposed rule, liquidity risk means the risk that a systemically important insurance company's financial condition or safety and soundness will be adversely affected by its actual or perceived inability to meet its cash and collateral obligations.

The proposed rule would require a systemically important insurance company to meet key internal control requirements with respect to liquidity risk management, to generate comprehensive cash-flow projections, to establish and monitor its liquidity risk tolerance, and to maintain a contingency funding plan to manage liquidity stress events when normal sources of funding may not be available. The proposed rule also would introduce liquidity stress-testing requirements for a systemically important insurance company and would require the company to maintain liquid assets sufficient to meet net cash outflows for 90 days over the range of liquidity stress scenarios used in the internal stress testing.

#### B. Internal Control Requirements

To reduce the risk of failure triggered by a liquidity event, the proposed rule would require a systemically important insurance company's board of directors, risk committee, and senior management to fulfill key corporate governance and internal control functions with respect to liquidity risk management. The proposed rule would also require a systemically important insurance company to institute an independent review function to provide an objective assessment of the company's liquidity risk-management framework.

##### 1. Board of Directors and Risk Committee Responsibilities

The proposed rule would require a systemically important insurance company's board of directors to approve at least annually the company's liquidity risk tolerance. This liquidity risk tolerance should set forth the acceptable level of liquidity risk that a systemically important insurance company may assume in connection with its operating strategies and should take into account the company's capital structure, risk profile, complexity, activities, and size. Typically, more liquid, shorter-duration assets provide lower expected returns than similar assets with longer durations. Risk tolerances should be articulated in a way that all levels of management can clearly understand and apply these tolerances to all aspects of liquidity risk management throughout the organization. In addition, the proposal

would require the board of directors to (1) review liquidity risk practices and performance at least semi-annually to determine whether the systemically important insurance company is operating in accordance with its established liquidity risk tolerance, and (2) approve and periodically review the liquidity risk-management strategies, policies, and procedures established by senior management.

The proposal would also require the risk committee or a designated subcommittee of the risk committee to review and approve the systemically important insurance company's contingency funding plan at least annually and whenever the company materially revises the plan. As discussed below, the contingency funding plan is the systemically important insurance company's compilation of policies, procedures, and action plans for managing liquidity stress events. In fulfilling this proposed requirement, the risk committee or designated subcommittee would report the results of its review to a systemically important insurance company's board of directors.

## 2. Senior Management Responsibilities

To ensure that a systemically important insurance company properly implements its liquidity risk-management framework within the tolerances established by the company's board of directors, the Board is proposing to require senior management of a systemically important insurance company to be responsible for several key liquidity risk-management functions.

First, the proposed rule would require senior management to establish and implement strategies, policies, and procedures designed to manage effectively the systemically important insurance company's liquidity risk. In addition, the proposal would require that senior management oversee the development and implementation of liquidity risk measurement and reporting systems and determine at least quarterly whether the systemically important insurance company is operating in accordance with such policies and procedures and is in compliance with the liquidity risk-management, stress-testing, and buffer requirements.

Second, the proposal would require senior management to report at least quarterly to the board of directors or the risk committee on the systemically important insurance company's liquidity risk profile and liquidity risk tolerance. More frequent reporting would be warranted if material changes

in the company's liquidity profile or market conditions occur.

Third, before a systemically important insurance company offers a new product or initiates a new activity that could potentially have a significant effect on the systemically important insurance company's liquidity risk profile, senior management would be required to evaluate the liquidity costs, benefits, and risks of the product or activity and approve it. As part of the evaluation, senior management would be required to determine whether the liquidity risk associated with the new product or activity (under both current and stressed conditions) is within the company's established liquidity risk tolerance. In addition, senior management would be required to review at least annually significant business activities and products to determine whether any of these activities or products creates or has created any unanticipated liquidity risk and whether the liquidity risk of each activity or product is within the company's established liquidity risk tolerance. An example of a significant business activity might include a company's securities lending operations or a particular line of business such as the issuance of funding agreements. This review should be done on a granular enough basis to allow for consideration of material differences in liquidity risk that might occur across jurisdictions or product features, such as a market value adjustment feature in an insurance contract.<sup>27</sup>

Fourth, senior management would be required to review the cash-flow projections (as described below) at least quarterly to ensure that the liquidity risk of the systemically important insurance company is within the established liquidity risk tolerance.

Fifth, senior management would be required to establish liquidity risk limits and review the company's compliance with those limits at least quarterly. As described in § 252.164(g) of the proposed rule, systemically important insurance companies would be required to establish limits on (1) concentrations in sources of funding by instrument type, single counterparty, counterparty type, secured and unsecured funding, and as applicable, other forms of liquidity risk; (2) potential sources of liquidity risk arising from insurance liabilities; (3) the amount of non-insurance liabilities that mature within various time horizons; and (4) off-balance sheet exposures and other

exposures that could create funding needs during liquidity stress events. In addition, the proposal would require the size of each limit to be consistent with the company's established liquidity risk tolerance and reflect the company's capital structure, risk profile, complexity, activities, and size.

Sixth, senior management would be required to (1) approve the liquidity stress testing practices, methodologies, and assumptions as set out in § 252.165(a) of the proposed rule at least quarterly and whenever the systemically important insurance company materially revises such practices, methodologies, or assumptions; (2) review at least quarterly both the liquidity stress-testing results produced under § 252.165(a) of the proposed rule and the liquidity buffer provided in § 252.165(b) of the proposed rule; and (3) review periodically the independent review of the liquidity stress tests under § 252.165(d) of the proposed rule.

The proposal would allow a systemically important insurance company to assign these senior management responsibilities to its chief risk officer, who would be considered a member of the senior management of the systemically important insurance company.

*Question 7: The Board invites comment on whether there are additional liquidity risk-management responsibilities that the rule should require of senior management.*

## 3. Independent Review

An independent review function is a critical element of a financial institution's liquidity risk-management program because it can identify weaknesses in liquidity risk management that would be overlooked by the management functions that execute funding. Accordingly, the Board is proposing to require a systemically important insurance company to maintain an independent review function that meets frequently (but no less than annually) to review and evaluate the adequacy and effectiveness of the company's liquidity risk-management processes, including its liquidity stress-test processes and assumptions. Under the proposal, this review function would be required to be independent of management functions that execute funding (e.g., the treasury function), but it would not be required to be independent of the liquidity risk-management function. In addition, the proposal would require the independent review function to assess whether the company's liquidity risk-management framework complies with applicable laws, regulations, supervisory guidance,

<sup>27</sup> Market value adjustment features tie the surrender value of an insurance contract to changes in market conditions.

and sound business practices, and report for corrective action any material liquidity risk-management issues to the board of directors or the risk committee.

An appropriate internal review conducted by the independent review function under the proposed rule should address all relevant elements of the liquidity risk-management framework, including adherence to the established policies and procedures and the adequacy of liquidity risk identification, measurement, and reporting processes. Personnel conducting these reviews should seek to understand, test, and evaluate the liquidity risk-management processes, document their review, and recommend solutions for any identified weaknesses.

### C. Cash Flow Projections

Comprehensive projections of cash flows from a firm's various operations are a critical tool to help the institution manage its liquidity risk. The proposal would require that the company produce comprehensive enterprise-wide cash-flow projections that project cash flows arising from assets, liabilities, and off-balance sheet exposures over short and long-term time horizons, including time horizons longer than one year. Longer time horizons are particularly important for insurance companies, which generally have liabilities that extend far into the future. In addition, tracking cash-flow mismatches can help a systemically important insurance company identify potential liquidity issues and facilitate asset liability management, particularly as it relates to reinvestment risk from interest rate changes. The proposal would require that the systemically important insurance company update short-term cash-flow projections daily and update longer-term cash-flow projections at least monthly. These updates would not always require revisiting actuarial estimates; however, the updates would need to roll the cash flows forward and revise assumptions as needed based on new data and changing market conditions.

To ensure that the cash flow projections would sufficiently analyze liquidity risk exposure to contingent events, the proposed rule would require that a systemically important insurance company establish a methodology for making projections that include all material liquidity exposures and sources, including cash flows arising from (1) anticipated claim and annuity payments; (2) policyholder options including surrenders, withdrawals, and policy loans; (3) collateral requirements on derivatives and other obligations; (4) intercompany transactions; (5)

premiums on new and renewal business; (6) expenses; (7) maturities and renewals of funding instruments, including through the operation of any provisions that could accelerate the maturity; and (8) investment income and proceeds from assets sales. The proposal would require that the methodology (1) include reasonable assumptions regarding the future behavior of assets, liabilities, and off-balance sheet exposures, (2) identify and quantify discrete and cumulative cash flow mismatches over various time periods, and (3) include sufficient detail to reflect the capital structure, risk profile, complexity, currency exposure, activities, and size of the systemically important insurance company, and any applicable legal and regulatory requirements. The proposal provides that analyses may be categorized by business line, currency, or legal entity.

Given the critical importance that the methodology and underlying assumptions play in liquidity risk management, a systemically important insurance company would be required to adequately document its methodology and assumptions used in making its cash flow projections.

*Question 8: The Board invites comment on whether the above requirements are appropriate for managing cash flows at systemically important insurance companies. Should any aspects of this cash-flow projection requirement be modified to better address the risk of systemically important insurance companies?*

*Question 9: Should the Board consider a different level of frequency for requiring systemically important insurance companies to update their cash flow projections? If so, what frequency would be appropriate and why?*

### D. Contingency Funding Plan

Under the proposed rule, a systemically important insurance company would be required to establish and maintain a contingency funding plan for responding to a liquidity crisis, identify alternate liquidity sources that the company can access during liquidity stress events, and describe steps that should be taken to ensure that the company's sources of liquidity are sufficient to fund its normal operating requirements under stress events. These provisions require the firm to develop and put in place plans designed to ensure that the firm will have adequate sources of liquidity to meet its obligations during the normal course of business. The proposal does not itself set a minimum liquidity requirement that would apply to all firms.

The proposal would require the contingency funding plan to include a quantitative assessment, an event management process, and monitoring requirements. The proposal would also require the plan to be commensurate with a systemically important insurance company's capital structure, risk profile, complexity, activities, size, and established liquidity risk tolerance.

Under the proposed rule, a systemically important insurance company would perform a quantitative assessment to identify liquidity stress events that could have a significant effect on the company's liquidity, assess the level and nature of such effect, and assess available funding sources during identified liquidity events. Such an assessment should delineate the various levels of stress severity that could occur during a stress event and identify the various stages for each type of event, spanning from the event's inception until its resolution. The types of events would include temporary, intermediate, and long-term disruptions. Under the proposal, possible stress events may include deterioration in asset quality, a spike in interest rates, an insurance catastrophe such as a pandemic that results in a large number of claims, an equity market decline, multiple ratings downgrades, a widening of credit default swap spreads, operating losses, negative press coverage, or other events that call into question a systemically important insurance company's liquidity. The stress events should be forecast in a comprehensive way across legal entities to identify gaps on an enterprise-wide basis. In addition, the proposal would require a systemically important insurance company to incorporate information generated by liquidity stress testing.

The proposed rule would provide that a systemically important insurance company include in its contingency funding plan procedures for monitoring emerging liquidity stress events and identifying early warning indicators that are tailored to the company's capital structure, risk profile, complexity, activities, and size. Early warning indicators should include negative publicity concerning an asset class owned by the company, potential deterioration of the company's financial condition, a rating downgrade, and/or a widening of the company's debt or credit default swap spreads. In addition, a systemically important insurance company's contingency funding plan would be required to at least incorporate collateral and legal entity liquidity risk monitoring.

As part of the quantitative assessment, a systemically important insurance

company would be required to include in its contingency funding plan both an assessment of available funding sources and needs and an identification of alternative funding sources that may be used during the identified liquidity stress events. To determine available and alternative funding sources, a systemically important insurance company would be expected under the proposal to analyze the potential erosion of available funding at various stages and severity levels of each stress event and identify potential cash flow mismatches that may occur. This analysis would include all material on- and off-balance sheet cash flows and their related effects, and would be based on a realistic assessment of both the behavior of policyholders and other counterparties and of a systemically important insurance company's cash inflows, outflows, and funds that would be available (after considering restrictions on the transferability of funds within the group) at different time intervals during the identified liquidity stress event. In addition, a systemically important insurance company should work proactively to have in place any administrative procedures and agreements necessary to access any alternative funding source.

The proposed rule would also require a systemically important insurance company's contingency funding plan to identify the circumstances in which the company would implement an action plan to respond to liquidity shortfalls for identified liquidity stress events. The action plan would clearly describe the strategies that a systemically important insurance company would use during such an event, including (1) the methods that the company would use to access alternative funding sources, (2) the identification of a management team to execute the action plan, (3) the process, responsibilities, and triggers for invoking the contingency funding plan, and (4) the decision-making process during the identified liquidity stress events and the process for executing the action plan's contingency measures. In addition, the proposal sets out reporting and communication requirements to facilitate a systemically important insurance company's implementation of its action plan during an identified liquidity stress event.

The proposal would require that a systemically important insurance company periodically test (1) the components of its contingency funding plan to assess its reliability during liquidity stress events, (2) the operational elements of the contingency funding plan, and (3) the methods the

company would use to access alternative funding sources to determine whether those sources would be available when needed. The tests required by the proposal would focus on the operational aspects of the contingency funding plan. This can often be done via "table-top" or "war-room" type exercises. In some cases, the testing would also require actual liquidation of assets in the buffer periodically as part of the exercise. This can be critical in demonstrating treasury control over the assets and an ability to convert the assets into cash. With proper planning, this can be done in a way that does not send a distress signal to the marketplace.

Market circumstances and the composition of a systemically important insurance company's business and product mix change over time. These types of changes could affect the effectiveness of a systemically important insurance company's contingency funding plan. To ensure that the contingency funding plan remains useful and instructive, the proposal would require a systemically important insurance company to update its contingency funding plan at least annually, and more frequently when changes to market and idiosyncratic conditions warrant.

*Question 10: The Board invites comment on whether the above requirements for a contingency funding plan are appropriate for systemically important insurance companies. What alternative approaches to the contingency funding requirements outlined above should the Board consider?*

*Question 11: Should the proposed rule allow systemically important insurance companies to plan for any delay or stay of payments to policyholders or other counterparties within their contingency funding plans? Why or why not?*

*Question 12: What specific information should a systemically important insurance company be required to include in its action plan to describe the strategies that the company would use to respond to liquidity shortfalls for identified liquidity stress events?*

#### *E. Collateral, Legal Entity, and Intraday Liquidity Risk Monitoring*

The proposal would require a systemically important insurance company to establish and maintain procedures for monitoring collateral, legal entity, and intraday liquidity risk. Robust monitoring of collateral availability, legal entity level liquidity, and intraday liquidity risk triggers

contribute to effective and appropriate management of potential or evolving liquidity stress events.

Under the proposal, the systemically important insurance company would be required to establish and maintain procedures to monitor assets that have been, or are available to be, pledged as collateral in connection with transactions to which it or its affiliates are counterparties. The policies and procedures would include the frequency in which a systemically important insurance company calculates its collateral positions, requirements for a company to monitor the levels of unencumbered assets (as discussed in section III.F.2, below) available to be pledged and shifts in a company's funding patterns, and requirements for a company to track operational and timing requirements associated with accessing collateral at its physical location.

A systemically important insurance company would also be required under the proposal to establish and maintain policies and procedures for monitoring and controlling liquidity risk exposures and funding needs within and across significant legal entities, currencies, and business lines, taking into account legal and regulatory restrictions on the transfer of liquidity among legal entities.

The proposal would require a systemically important insurance company to maintain policies and procedures for monitoring the intraday liquidity risk exposure of the company, as applicable to its business, including obligations that must be settled at a specific time within the day or where intraday events could affect a systemically important insurance company's liquidity positions in a material and adverse manner. For instance, the company should have procedures in place to monitor the risk that an intraday movement in equity prices or the price of hedge instruments could materially affect the company's liquidity position. If applicable, these procedures would be required to address, among other things, how the systemically important insurance company will prioritize payments and derivative transactions to settle critical obligations and effectively hedge its risks.

*Question 13: The Board invites comments on whether there are specific activities that, if carried out by a systemically important insurance company, should result in a requirement that the company engage in intraday liquidity monitoring?*



### *F. Liquidity Stress-Testing and Buffer Requirements*

To reduce the risk of a systemically important insurance company's failure due to adverse liquidity conditions, the proposal would require a systemically important insurance company to conduct rigorous and regular stress testing and scenario analysis that incorporate comprehensive information about its funding position under both normal circumstances, when regular sources of liquidity are readily available, and adverse conditions, when liquidity sources may be limited or severely constrained. The purpose of the proposed rule's liquidity stress testing and buffer requirements would be to ensure that the holding company (or another entity within the consolidated organization that is not subject to transfer restrictions) has the ability to transfer liquid assets to a legal entity within the consolidated organization that has a liquidity need so that a liquidity crisis can be avoided.

#### 1. Liquidity Stress-Testing Requirement

Under the proposed rule, a systemically important insurance company would be required to conduct liquidity stress tests that, at a minimum, involve macroeconomic, sector-wide, and idiosyncratic events (for example, including natural and man-made catastrophes) affecting the firm's cash flows, liquidity position, profitability, and solvency. The liquidity stress tests should span the different types of liquidity events that a systemically important insurance company could face. This includes both a fast-moving scenario in which an event triggers many withdrawal requests and collateral calls as well as a more sustained scenario where the systemically important insurance company's liquidity deteriorates slowly over the course of a year or longer. In conducting its liquidity stress tests, a systemically important insurance company would be required under the proposal to take into account its current liquidity condition, risks, exposures, strategies, and activities, as well as its balance sheet exposures, off-balance sheet exposures, size, risk profile, complexity, business lines, organizational structure, and other characteristics that affect its liquidity risk profile. The proposal would require a systemically important insurance company to conduct its liquidity stress tests monthly, or more frequently as required by the Board.

In conducting its liquidity stress tests, a systemically important insurance company would be required to address

the potential direct adverse effect of associated market disruptions on the company and incorporate the potential actions of counterparties, policyholders, and other market participants experiencing liquidity stresses that could adversely affect the company.

As explained above, for purposes of the proposed rule, liquidity risk would encompass risks relating to collateral posting requirements. By virtue of their hedging and non-insurance operations, insurers can have large and directional derivative positions with associated collateral requirements. A systemically important insurance company would be required by the proposal to account for such hedges in its liquidity stress testing to ensure that it would have sufficient sources of assets available for posting.

Effective liquidity stress testing should be conducted over a variety of different time horizons to capture rapidly developing events and other conditions and outcomes that may materialize in the near or long term. While some types of stresses can emerge quickly for systemically important insurance companies, such as collateral calls on derivatives positions, many insurance stresses take more time to develop and provide a slower draw on cash and funds relative to the stresses that affect other financial institutions. For instance, while a natural catastrophe might cause a large number of claims seeking reimbursement for property damage, these claims will typically be paid over a several year period as the properties are rebuilt and many claims are litigated. To ensure that a systemically important insurance company's stress testing captures such events, conditions, and outcomes, the proposed rule would require that a systemically important insurance company's liquidity stress scenarios use a minimum of four time horizons: 7 days, 30 days, 90 days, and one year. The proposal would also require systemically important insurance companies to include any other planning horizons that are relevant to its liquidity risk profile.

Under the proposal, a systemically important insurance company would be required to incorporate certain assumptions designed to ensure that its liquidity stress tests provide relevant information to support the establishment of the liquidity buffer. For stress tests less than the 90-day period used to set the liquidity buffer, cash-flow sources could not include any sales of assets that are not eligible for inclusion in the liquidity buffer, as defined below. Additionally, cash-flow sources should not include borrowings from sources such as lines of credit or

the Federal Home Loan Bank. While these can provide valuable sources of liquidity, the allowance of off-balance sheet funding to decrease the liquidity buffer requirement would encourage firms to place undue reliance on these transactions, which may not be available when needed in times of stress. Additionally, the borrowings could serve to exacerbate systemic risk by spreading risk to other significant financial institutions. Systemically important insurance companies could incorporate into the stress tests other cash-flow sources, including future premiums, and would be expected to make conservative assumptions that are consistent with the stress scenario regarding the availability of these sources over the planning horizon.

In all liquidity stress tests, the proposal would require systemically important insurance companies to appropriately address assets in restricted accounts such as those in legally-insulated separate accounts and in any closed block.<sup>28</sup> Changes in the value of these assets can affect the rest of the insurer's balance sheet through guarantees and hedging programs. Additionally, sales or purchases of large amounts of assets in these accounts can affect the markets more broadly. Consequently, separate account assets and closed block assets could be included as cash-flow sources only in proportion to the cash flow needs in these same accounts. Separate account assets have first priority to meet separate account commitments and would not be available to meet general account liquidity needs.

The proposed rule would require a systemically important insurance company to impose a discount to the fair market value of an asset that is used as a cash-flow source to offset projected funding needs in order to help account for credit risk and market volatility of the asset when there is market stress. The discounts would be required to appropriately reflect differences in credit and market volatilities across asset types. The proposed rule would require that sources of funding used to generate cash to offset projected funding needs be sufficiently diversified throughout each stress test time horizon.

The proposed rule further provides that liquidity stress testing must be tailored to, and provide sufficient detail to reflect, a systemically important

<sup>28</sup> Closed blocks are discrete pools of assets that are set aside to support the dividend expectations of participating policyholders from the periods prior to demutualization. Typically, changes of their values would be largely offset by future changes in the dividend rates on these participating policies.

insurance company's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors. This requirement is intended to ensure that the proposed liquidity stress testing is tied directly to a systemically important insurance company's business profile and the regulatory environment in which the company operates; provides for the appropriate level of aggregation; captures all appropriate risk drivers, including internal and external influences; and incorporates other key considerations that may affect the company's liquidity position. In addition, a systemically important insurance company's liquidity stress testing scenarios should appropriately capture limitations on the transfer of funds.

The proposed rule would not allow a systemically important insurance company to assume for the purposes of stress testing that the company would delay payments under insurance contracts. Although many insurance contracts allow insurers to defer payments by up to six months at the election of either the company or their insurance regulator, the proposal would not allow firms to assume such deferrals in liquidity stress testing. Crediting stays would be inconsistent with preventing the failure or material financial distress of a systemically important insurance company. Stays are measures of last resort that systemically important insurance companies would be very hesitant to invoke for reputational reasons. Because of this, assuming claims payments would be delayed also may not be realistic. Additionally, a stay by a systemically important insurance company could have substantial adverse systemic implications.

The proposed rule would impose various governance requirements related to a systemically important insurance company's liquidity stress testing. First, a systemically important insurance company would be required to establish and maintain certain policies and procedures governing its liquidity stress testing practices, methodologies, and assumptions. Second, a systemically important insurance company would be required to establish and maintain a system of controls and oversight to ensure that its liquidity stress testing processes are effective, including by ensuring that each stress test appropriately incorporates conservative assumptions around its stress test scenarios and the other elements of the stress test process. In addition, the proposal would require that the assumptions be approved by the chief risk officer and subject to review by the

independent review function. Third, the proposed rule would require a systemically important insurance company to maintain management information systems and data processes sufficient to enable it to collect, sort, and aggregate data and other information related to liquidity stress testing in an effective and reliable manner.

*Question 14: Are the proposed stress testing horizons ranging from seven days to one year appropriate?*

*Question 15: How often should systemically important insurance companies be required to conduct stress tests? What are the costs and benefits of such a frequency?*

*Question 16: What changes, if any, should be made to the definition of available cash-flow sources for the liquidity stress tests? How should the proposed standard treat separate account and closed block assets?*

*Question 17: In what scenario, if any, would delaying payments to policyholders be effective in allowing a systemically important insurance company to continue operating as a going concern without adverse impact to the company's reputation, ability to attract and retain business, and cash flows? Should systemically important insurance companies be allowed to assume that they would delay payments to policyholders in liquidity stress testing (including for purposes of calculating the liquidity buffer requirement described below)? If so, under which scenarios and planning horizons would this be appropriate and what documentation, planning, and other requirements should be placed around this? Are there historical data to support an alternative approach to the one contained in the proposal?*

*Question 18: What other changes, if any, should be made to the proposed liquidity stress-testing requirements (including the stress scenario requirements and required assumptions) to ensure that analyses of stress testing will provide useful information for the management of a systemically important insurance company's liquidity risk? What alternatives to the proposed liquidity stress-testing requirements, including the stress scenario requirements and required assumptions, should the Board consider? What additional parameters for the liquidity stress tests should the Board consider defining?*

## 2. Liquidity Buffer Requirement

The proposed rule would require a systemically important insurance company to maintain a liquidity buffer sufficient to meet net cash outflows for

90 days over the range of liquidity stress scenarios used in the internal stress testing. Although the Board requires large bank holding companies to use a 30-day period for the Dodd Frank Act section 165 liquidity buffer requirement under the Board's Regulation YY, this proposed 90-day period for systemically important insurance companies is consistent with the generally longer-term nature of insurance liabilities. The 90-day period represents an intermediate view between the length of a fast-moving liquidity scenario that transpires quickly over a month or less, and the length of a persistent liquidity scenario that could take longer than a year to resolve.

For the purposes of calculating the required buffer, the proposal would exclude intragroup transactions. Including intragroup outflows within the buffer calculation would result in double counting many transactions. For instance, if intragroup transactions were included when calculating the size of the buffer, a systemically important insurance company that uses a single legal entity to enter into derivative transactions for hedging could be penalized. Such a company would have to hold buffer assets not only for the derivative transaction with a third party, but also for any offsetting intra-group transactions that transfer the benefits of this hedge back to the legal entity with the hedged item. To account for the liquidity risks of intragroup transactions, this proposal instead places limitations on where the buffer can be held.

The proposal would limit the type of assets that may be included in the buffer to highly liquid assets that are unencumbered. Limitation of the buffer to highly liquid assets would ensure that the assets in the liquidity buffer can be converted to cash over a 90-day period with little or no loss of value. The proposal's definition of highly liquid assets is tailored to reflect the assets generally held by systemically important insurance companies and the 90-day stress test period proposed for a systemically important insurance company. Over a 90-day time period, the Board would expect that a wider variety of assets could be effectively liquidated than in a shorter period (e.g., 30 days).

For purposes of the proposed rule, highly liquid assets would include a range of assets, subject to the additional limitations discussed further below. Highly liquid assets would include securities backed by the full faith and credit of the U.S. government, and securities issued or guaranteed by a U.S. government sponsored enterprise if they

are investment-grade as defined by 12 CFR part 1 and the claim is senior to preferred stock. Highly liquid assets would include securities of sovereign entities outside of the U.S. as well as some international organizations, including the Bank for International Settlements, the International Monetary Fund, and the European Central Bank, if the security would have a risk weight below 20 percent under 12 CFR part 217 or the security is issued by a sovereign entity in its own currency and the systemically important insurance company holds the security in order to meet its stressed net cash outflows in the sovereign's jurisdiction.

Investment-grade corporate debt would also be eligible if the issuer's obligations have a proven record as reliable sources of liquidity during stressed market conditions. In addition, highly liquid assets would include publicly traded common equity shares if they are included in the Russell 1000 Index, issued by an entity whose publicly traded common equity shares have a proven record as a reliable source of liquidity during stressed market conditions, and, if held by a depository institution, were not acquired in satisfaction of a debt previously contracted. Investment-grade general obligation securities issued or guaranteed by public sector entities would be eligible under the same limitations as corporate debt.

To be included as highly liquid assets, all assets other than securities issued or guaranteed by the U.S. Treasury would have to be liquid and readily-marketable. To be liquid and readily marketable under the proposal, the security must be traded in an active secondary market with more than two committed market makers. There must also be a large number of non-market maker participants on both the buying and selling sides of the transactions and there must also be timely and observable market prices. Further, trading volume must be high. These requirements would help ensure that the included assets could be quickly converted to cash.

Because of the concerns about wrong-way risk that correlates with the broader economy and exacerbates stress and because of the potential for increased systemic risk due to counterparty exposures, most instruments issued by financial institutions would be excluded from the definition of highly liquid assets. Bonds from banks or insurance companies may not be included within the buffer. Similarly bank deposits would not be eligible because of potential contagion. If a systemically important insurance company were to

experience liquidity stress and withdraw its bank deposits, the stress event could be spread to other parts of the financial system as banks may be forced to liquidate assets in order to honor the withdrawals.

In addition to the enumerated assets, the proposal includes criteria that could be used to identify other assets to be included in the buffer as highly liquid assets. Specifically, the proposed definition of highly liquid assets includes any other asset that a systemically important insurance company demonstrates to the satisfaction of the Board (1) has low credit risk and low market risk, (2) is liquid and readily-marketable, and (3) is a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity has been impaired.

The proposal also would limit the type of assets in the liquidity buffer to assets that are unencumbered so as to be readily available at all times to meet a systemically important insurance company's liquidity needs. Under the proposed rule, unencumbered would be defined to mean an asset that is (1) free of legal, regulatory, contractual, and other restrictions on the ability of a systemically important insurance company promptly to liquidate, sell, or transfer the asset, and (2) not pledged or used to secure or provide credit enhancement to any transaction.

Because of intercompany restrictions on the transfer of funds, the proposal would limit where a systemically important insurance company can hold assets in the liquidity buffer. Assets held at regulated entities could be included in the buffer up to the amount of their net cash outflows as calculated under the internal liquidity stress tests plus any additional amounts that would be available for transfer to the top-tier holding company during times of stress without statutory, regulatory, contractual, or supervisory restrictions. The proposal would also require that the top-tier holding company hold an amount of highly liquid assets sufficient to cover the sum of all stand-alone material entity net liquidity deficits. The stand-alone net liquidity deficit of each material entity would be calculated as that entity's amount of net stressed outflows over a 90-day planning horizon less the highly liquid assets held at the material entity. For the purposes of evaluating liquidity deficits of material entities, systemically important insurance companies would be required to treat inter-affiliate exposures in the same manner as third-party exposures.

To account for deteriorations in asset valuations when there is market stress,

the proposed rule also would require a systemically important insurance company to impose a discount to the fair market value of an asset included in the liquidity buffer to reflect the credit risk and market volatility of the asset. Discounts relative to fair market value would be expected to appropriately reflect the 90-day forecast period used to calculate the buffer. Longer periods allow firms more time to liquidate assets strategically to minimize losses.

In addition, to ensure that the liquidity buffer is not concentrated in a particular type of highly liquid assets, the proposed rule provides that the pool of assets included in the liquidity buffer must be sufficiently diversified by instrument type, counterparties, geographic market, and other liquidity risk identifiers.

*Question 19: Is 90 days the right planning horizon for calculation of the buffer? Why or why not?*

*Question 20: Do the proposed rule's stress testing and liquidity buffer requirements appropriately capture restrictions on the transferability of funds between legal entities within a consolidated organization? Why or why not?*

*Question 21: The Board invites comment on all aspects of the proposed definition of "highly liquid assets". Does the definition appropriately reflect the range of assets that an insurer could use to meet cash outflows over the extended 90-day time horizon?*

*Question 22: Should the board include specific requirements that specify when an asset can be considered a source of liquidity during stress (e.g., less than a 20 percent drop in price within 30 days)? If so, what should those requirements be?*

*Question 23: Should bank deposits be eligible as highly liquid assets? Why or why not?*

*Question 24: What changes, if any, should be made to the proposal's guidance concerning the discounting of assets relative to their fair value? How should these discounts vary based on the length of the stress test's planning horizon?*

*Question 25: What changes, if any, should the Board make to the proposed definition of unencumbered to ensure that assets in the liquidity buffer will be readily available at all times to meet a systemically important insurance company's liquidity needs?*

*Question 26: The Board requests comment on all aspects of the proposed liquidity risk-management standard. What alternative approaches to liquidity risk management should the Board consider? Are the liquidity risk-management requirements of this*

*proposal too specific or too narrowly defined?*

#### **IV. Transition Arrangements and Ongoing Compliance**

To provide for reasonable time frames for systemically important insurance companies to develop and implement procedures, policies, and reporting, the Board is proposing to provide meaningful phase-in periods for these enhanced prudential standards. A company that is a systemically important insurance company on the effective date of the final rule would be required to comply with the corporate governance and risk-management standard and the liquidity risk-management standard of the proposed rule beginning on the first day of the fifth quarter following the effective date of the proposal. While the Board does not anticipate that, if the rule is adopted as proposed, systemically important insurance companies would be required to make extensive changes to their structures or risk governance frameworks, outside of certain improvements that the companies are already planning to implement, the five-quarter period would ensure that systemically important insurance companies would have at least one opportunity to make any needed changes at the board of directors level through a proxy vote. Systemically important insurance companies would be encouraged to comply earlier, if possible. For the liquidity risk-management standard, the five-quarter phase-in period would balance the need for this liquidity standard with the Board's expectation that more work would be required for the systemically important insurance companies to comprehensively project cash flows in a manner that supports the proposal's stress-testing requirement. A company that becomes a systemically important insurance company after the effective date of the proposed rule would be required to comply with the corporate governance and risk-management standard and the liquidity risk-management standard no later than the first day of the fifth quarter following the date on which the Council determined that the company should be supervised by the Board.

*Question 27: Are the proposed transition measures and compliance dates appropriate? What aspects of the proposed rule present implementation challenges and why? The Board invites comments on the nature and impact of these challenges and whether the Board should consider implementing transitional arrangements in the rule to address these challenges.*

#### **V. Impact Assessment**

In developing this proposal, the Board considered a variety of alternatives and considered an initial balancing of costs and benefits of the proposal. Based on the information currently available to the Board, the Board believes that the benefits of the proposal outweigh the relatively modest costs of the proposal. The Board notes that a number of the expected costs and benefits from the proposal, while real, are very difficult to measure or quantify. The Board invites comment and information regarding various alternatives, as well as regarding the costs and benefits of the alternatives and the Board's proposal.

The primary benefits of this proposal would be the results of improvement in the management and resiliency of affected companies that reduce the likelihood that a systemically important insurance company would fail or experience material financial distress. These improvements may also result in increased efficiencies at systemically important insurance companies through improvements in the identification of risks and resulting reductions in losses and costs of operation.

The systemically important insurance companies covered by this proposal are large, complex financial firms that the Council has determined the failure of which would likely cause risk to the financial stability of the United States. Benefits of a reduction in the probability of failure of one of these firms include avoiding: (1) The costs to the economy from the disruption of key markets or the creation of significant losses or funding problems for other firms with holdings similar to a systemically important insurance company; (2) the cost of such a failure to policyholders through lost payments and lost coverage; (3) the cost of an insurance failure to taxpayers and other insurers, who act as guarantors for large portions of a systemically important insurance company's obligations; and (4) the cost of a failure to a systemically important insurance company's creditors.

##### *A. Analysis of Potential Costs*

##### **1. Initial and Ongoing Costs To Comply**

The corporate governance and risk-management provisions of the proposal are expected to have only modest initial and ongoing costs for the affected companies. Under the proposal, systemically important insurance companies would be required to maintain a risk committee of the board of directors that approves and periodically reviews the risk-management policies of the systemically important insurance company's global

operations and oversees the operation of the systemically important insurance company's global risk-management framework. The systemically important insurance companies currently have board-level engagement on key risks, and any structural modifications to establish and operate a stand-alone risk committee of the board of the directors are likely to be modest.

Under the proposal, a systemically important insurance company's global risk-management framework would be required to include policies and procedures establishing risk-management governance, risk-management procedures, and risk control infrastructure for its global operations, as well as processes and systems for implementing and monitoring compliance with such procedures; identifying and reporting risks and risk-management deficiencies; establishing managerial and employee responsibility for risk management; ensuring the independence of the risk-management function; and integrating risk-management and associated controls with management goals and its compensation structure for its global operations. The systemically important insurance companies currently have both risk-management frameworks and policies already in place. They have already invested significant resources in building up their risk-management frameworks in recent years. The Board expects that these frameworks, along with the companies' planned improvements, would largely comply with the proposed standards. The proposal is designed to ensure that these policies and procedures are maintained and are developed as the risks within the firm change. The primary costs of maintaining and adapting these policies and procedures would be from the opportunity cost of management's time to make the changes to the framework, as well as the costs of establishing or improving new management information systems to assure the timely presentation of information to these senior level officials. These costs might also include additional staffing to administer the global risk-management framework.

Under the proposal, systemically important insurance companies also would be required to have a chief risk officer and a chief actuary. The systemically important insurance companies currently have both a chief risk officer and a chief actuary or co-chief actuaries. The proposal may require the companies to modify their reporting structures and compensation to ensure that the positions have sufficient stature and independence

from individual profit centers in order to comply with the proposal. The costs associated with such changes could include, but may not be limited to, ongoing payroll and benefit costs and the opportunity cost of the time spent making the necessary changes. These costs are expected to be minimal.

Under the proposed liquidity risk-management standard, systemically important insurance companies would be required to meet key internal control requirements with respect to liquidity risk management. The companies currently have existing processes in place to oversee liquidity risk. These processes, along with planned improvements, would largely comply with the liquidity risk-management standard's internal control requirements. Some additional changes may be required pertaining to new product approval and to ensure periodic review of all significant products and activities for liquidity risk features. These costs are expected to be relatively small.

The proposed rule would also require systemically important insurance companies to generate comprehensive cash flow projections. Both companies have procedures in place to generate cash-flow projections. Additional work may be needed to ensure that all cash flows, including those in unregulated or run-off entities, are included within the projections, and to ensure that the cash-flow projections are timely and updated at the appropriate frequency. The additional frequency of updating might require systemically important insurance companies to either hire additional staff to run these projections or to build or buy new systems that can produce these comprehensive forecasts in a timely and efficient manner. Because these firms already have in place basic infrastructure to make these projections, any marginal costs to meet the minimum requirements under the proposal are expected to be relatively modest.

The proposed rule would also require systemically important insurance companies to maintain a contingency funding plan. Both systemically important insurance companies have plans in place to respond to a liquidity crisis, and both are working to develop these plans further. Some additional work on these plans may be required to meet the requirements of the proposed rule, such as quantitatively assessing cash-flow needs and sources across legal entities.

The proposed rule also would require systemically important insurance companies to conduct liquidity stress tests and require the systemically

important insurance companies to maintain liquid assets sufficient to meet net cash outflows for 90 days over the range of liquidity stress scenarios used in the internal stress tests. Both of the systemically important insurance companies have systems in place to project the company's liquidity position under stressed conditions. However, the proposal may cause the systemically important insurance companies to update these systems to facilitate monthly testing and ensure that the scenarios include all exposures and entities within the systemically important insurance company. The costs associated with these improvements are expected to be modest within the context of the organizations and could include, but may not be limited to, the costs to recruit and hire staff, including ongoing payroll and benefits costs, and the costs of development and implementation of management information systems with appropriate data to support analysis and reporting on a monthly frequency.

In addition, systemically important insurance companies may need to make balance sheet adjustments in order to come into and maintain compliance with the proposed liquidity risk-management requirements, if adopted as proposed. While both systemically important insurance companies currently appear to maintain an adequate amount of liquidity on a consolidated basis, some movement of funds between legal entities may be required to provide appropriate responsiveness in times of stress.

## 2. Impact on Premiums and Fees

The initial and ongoing costs of complying with the standard, if adopted as proposed, could affect the premiums and fees that the systemically important insurance companies charge. Insurance products are priced to allow insurers to recover their costs and earn a fair rate of return on their capital. In the long run, all costs of providing a policy are borne by policyholders.

Because the expected costs associated with implementing the proposal, if adopted, are not expected to be material within the context of the institutions' existing budgets, there is not expected to be a material change in the pricing of systemically important insurance companies' products from the proposed standards, if adopted as proposed. Moreover, the better identification and management of risk that is expected to result from the proposal may lead to improved efficiencies, fewer losses, and lower costs in the long term, which may offset the effects of the costs of compliance on premiums.

## 3. Reduced Financial Intermediation

If premiums or fees increase on some or all products, it could discourage some potential customers from purchasing these products. However, the possibility of reduced financial intermediation or economic output in the United States related to the proposed rule's corporate governance and risk-management standard and liquidity risk-management standard appears unlikely.

### *B. Analysis of Potential Benefits*

Based on an initial assessment of available information, the benefits of the proposed standards are expected to outweigh the costs. Most significantly, the intent of the proposed rule is to reduce the probability of a systemically important insurance company failing or experiencing material financial distress. Even small changes in the probability of a systemically important firm failing can confer large expected benefits because of the enormous cost of financial crises. Additionally, the proposal would have an ancillary benefit of facilitating an orderly resolution of a systemically important insurance company, and could increase consumer confidence in the companies. Moreover, as explained below, improved risk management may improve efficiency by reducing losses and costs in the long term.

#### 1. Benefits From a Reduction in the Likelihood That a Systemically Important Insurance Company Would Fail or Experience Material Financial Distress

This proposal is intended to reduce the risk that a systemically important insurance company would experience material financial distress or fail. A reduction of this probability carries numerous direct and indirect benefits.

The most important benefit from a reduction in the probability of default of a systemically important insurance company is a decreased potential for a potential negative impact on the United States economy caused by the failure or material financial distress of a systemically important insurance company. The Council has determined that material financial distress at each of the systemically important insurance companies could cause an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy. A reduction in the probability of failure or material financial distress at both systemically important insurance companies would promote financial stability and concomitantly materially

reduce the probability that a financial crisis would occur in any given year. The proposed rule would therefore advance a key objective of the Dodd-Frank Act and help protect the American economy from the substantial potential losses associated with a higher probability of financial crises.

In addition to the benefits to the broader economy, a reduction in a systemically important insurance company's default probability benefits its counterparties. The majority of funding for systemically important insurance companies comes from policyholders. Some of these policyholders would bear losses if the company were to fail. These losses can take the form of reduced payment for claims, reduced amounts available for withdrawal from policyholder accounts, or long delays.

The overall costs of these losses to policyholders extend beyond just their dollar value. Policyholders purchase insurance policies because they provide money when it is most needed. Insurance policies can replace lost wages when a policyholder is disabled or help a policyholder afford shelter after a natural catastrophe destroys his or her home and possessions. Other policyholders might not yet have experienced a loss event, but could be unable to obtain new coverage in the event a systemically important insurance company fails. For instance, an elderly policyholder who purchased a whole life contract many years ago would likely have difficulty obtaining a replacement policy.

Reducing the probability of a systemically important insurance company's failure or distress decreases the expected costs to policyholders, taxpayers, other counterparties, other insurance companies, and the financial system generally.

The proposal is also expected to benefit other creditors of systemically important insurance companies. In the event of a failure, the lenders and general creditors of a company also experience losses. While it is not the primary goal of this proposed regulation to protect these parties, they could potentially benefit.

The savings from a reduced probability of default would also have indirect benefits. They could also translate into lower borrowing costs for systemically important insurance companies. The lower costs could also affect insurance premiums. If systemically important insurance companies expect lower guaranty fund assessment costs, these savings could be passed on to policyholders in the form of lower premiums and fees. These

savings are, however, unlikely to be material.

## 2. A Reduction in the Impact of a Firm's Failure or Distress on the Economy

While the primary benefit of the proposed rule would be a reduction in the probability of a firm failing or experiencing material financial distress, the proposed rule is also expected to produce benefits in a resolution of a systemically important insurance company. Liquidity is valuable in resolutions, and the restrictions on the liquidity buffer that require the buffer to be held at the holding company to be down-streamed, could facilitate a variety of strategies for an orderly resolution.

## 3. Improved Efficiencies Resulting From Better Risk Management

The proposed rule may result in efficiencies at systemically important insurance companies through improved risk-management practices. The proposed rule is expected to improve systemically important insurance companies' internal controls and identification and management of risks that may arise through their activities and investments. For example, the increased internal controls and liquidity stress-testing requirements could result in a systemically important insurance company discovering that a product's liquidity risks are different than it previously estimated and thus result in the systemically important insurance company being able to price that product in a way that more accurately reflects its risks. If systemically important insurance companies are better able to manage risk, then over the long term, the proposed rule may result in decreased losses and related costs to systemically important insurance companies.

*Question 28: 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?*

## VI. Administrative Law Matters

### A. Solicitation of Comments on the Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106–102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board has sought to present the proposed rule in a simple and

straightforward manner, and invites comment on the use of plain language.

### B. Paperwork Reduction Act Analysis

Certain provisions of the proposed rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number is 7100–NEW. The Board reviewed the proposed rule under the authority delegated to the Board by the OMB.

The proposed rule contains requirements subject to the PRA. The recordkeeping requirements are found in sections 252.164(e)(3), 252.164(f), 252.164(h), and 252.165(a)(7). These information collection requirements would be implemented pursuant to section 165 of the Dodd-Frank Act for systemically important insurance companies.

Comments are invited on:

(a) Whether the collections of information are necessary for the proper performance of the Board's functions, including whether the information has practical utility;

(b) The accuracy of the Board's estimate of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the **ADDRESSES** section. A copy of the comments may also be submitted to the OMB desk officer: By mail to U.S. Office of Management and Budget, 725 17th Street NW., #10235, Washington, DC 20503 or by facsimile to 202–395–5806, Attention, Federal Reserve Desk Officer.

## Proposed Information Collection

*Title of Information Collection:*  
Recordkeeping Requirements  
Associated with Enhanced Prudential  
Standards (Regulation YY).

*Agency Form Number:* Reg YY-1.

*OMB Control Number:* 7100—NEW.

*Frequency of Response:* Annual.

*Affected Public:* Businesses or other  
for-profit.

*Respondents:* Systemically important  
insurance companies.

*Abstract:* Section 165 of the Dodd-Frank Act requires the Board to implement enhanced prudential standards for nonbank financial companies that the Council has determined should be supervised by the Board. Section 165 of the Dodd-Frank Act also permits the Board to establish such other prudential standards for such companies as the Board determines are appropriate.

*Current Actions:* Pursuant to section 165 of the Dodd-Frank Act, the Board is proposing the application of enhanced prudential standards to certain nonbank financial companies that the Council has determined should be supervised by the Board. The Board is proposing corporate governance, risk-management, and liquidity risk-management standards that are tailored to the business models, capital structures, risk profiles, and systemic footprints of the nonbank financial companies with significant insurance activities.

Section 252.164(e)(3) would require a systemically important insurance company to adequately document its methodology for making cash flow projections and the included assumptions.

Section 252.164(f) would require a systemically important insurance company to establish and maintain a contingency funding plan that sets out the company's strategies for addressing liquidity needs during liquidity stress events and describes the steps that should be taken to ensure that the systemically important insurance company's sources of liquidity are sufficient to fund its normal operating requirements under stress events. To operate normally, a firm must have sufficient funding to pay obligations in the ordinary course as they become due and meet all solvency requirements for the writing of new and renewal policies. The contingency funding plan must be commensurate with the company's capital structure, risk profile, complexity, activities, size, and established liquidity risk tolerance. The company must update the contingency funding plan at least annually, and when changes to market and

idiosyncratic conditions warrant. The contingency funding plan must include specified quantitative elements, an event management process that sets out the systemically important insurance company's procedures for managing liquidity during identified liquidity stress events, and procedures for monitoring emerging liquidity stress events. The procedures must identify early warning indicators that are tailored to the company's capital structure, risk profile, complexity, activities, and size.

Section 252.164(h)(1) would require a systemically important insurance company to establish and maintain policies and procedures to monitor assets that have been, or are available to be, pledged as collateral in connection with transactions to which it or its affiliates are counterparties and sets forth minimum standards for those procedures.

Section 252.164(h)(2) would require a systemically important insurance company to establish and maintain procedures for monitoring and controlling liquidity risk exposures and funding needs within and across significant legal entities, currencies, and business lines, taking into account legal and regulatory restrictions on the transfer of liquidity between legal entities.

Section 252.164(h)(3) would require a systemically important insurance company to establish and maintain procedures for monitoring intraday liquidity risk exposure of the systemically important insurance company if necessary for its business. These procedures must address how the management of the systemically important insurance company will (1) monitor and measure expected daily gross liquidity inflows and outflows, (2) identify and prioritize time-specific obligations so that the systemically important insurance company can meet these obligations as expected and settle less critical obligations as soon as possible, (3) coordinate the purchase and sale of derivatives so as to maximize the effectiveness of their hedging programs, (4) consider the amounts of collateral and liquidity needed to meet obligations when assessing the systemically important insurance company's overall liquidity needs, and (5) where necessary, manage and transfer collateral to obtain intraday credit.

Section 252.35(a)(7) would require a systemically important insurance company to establish and maintain policies and procedures governing its liquidity stress testing practices, methodologies, and assumptions that

provide for the incorporation of the results of liquidity stress tests in future stress testing and for the enhancement of stress testing practices over time. The systemically important insurance company would establish and maintain a system of controls and oversight that is designed to ensure that its liquidity stress testing processes are effective in meeting the final rule's stress-testing requirements. The systemically important insurance company would maintain management information systems and data processes sufficient to enable it to effectively and reliably collect, sort, and aggregate data and other information related to liquidity stress testing.

## Estimated Paperwork Burden

*Number of Respondents:* 2  
systemically important insurance  
companies.

*Estimated Burden per Response:* 200  
hours (Initial set-up 160 hours).

*Estimated Annual Burden:* 720 hours  
(320 hours for initial set-up and 400  
hours for ongoing compliance).

## C. Regulatory Flexibility Act Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act<sup>29</sup> (RFA), the Board is publishing an initial regulatory flexibility analysis of the proposed rule. The RFA requires an agency either to provide an initial regulatory flexibility analysis with a proposed rule for which a general notice of proposed rulemaking is required or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. Based on its analysis and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, the Board is publishing an initial regulatory flexibility analysis. A final regulatory flexibility analysis will be conducted after comments received during the public comment period have been considered.

In accordance with section 165 of the Dodd-Frank Act, the Board is proposing to adopt Regulation YY (12 CFR 252 *et seq.*) to establish enhanced prudential standards for systemically important insurance companies.<sup>30</sup> The enhanced standards include liquidity standards and requirements for overall risk-management (including establishing a risk committee) for companies that the Council has determined pose a grave threat to financial stability.

<sup>29</sup> 5 U.S.C. 601 *et seq.*

<sup>30</sup> See 12 U.S.C. 5365 and 5366.

Under Small Business Administration (SBA) regulations, the finance and insurance sector includes direct life insurance carriers and direct property and casualty insurance carriers, which generally are considered “small” if a life insurance carrier has assets of \$38.5 million or less or if a property and casualty insurance carrier has less than 1,500 employees.<sup>31</sup> The Board believes that the finance and insurance sector constitutes a reasonable universe of firms for these purposes because such firms generally engage in activities that are financial in nature. Consequently, systemically important insurance companies with asset sizes of \$38.5 million or less if such an entity is a life insurance carrier and less than 1,500 employees if such an entity is a property and casualty insurance carrier are small entities for purposes of the RFA.

As discussed in the **SUPPLEMENTARY INFORMATION**, the proposed rule generally would apply to a systemically important insurance company, which includes only nonbank financial companies that the Council has determined under section 113 of the Dodd-Frank Act must be supervised by the Board and for which such determination is in effect. Companies that are subject to the proposed rule therefore substantially exceed the \$38.5 million asset threshold at which a life insurance entity and the less than 1,500 employee threshold at which a property and casualty entity is considered a “small entity” under SBA regulations. The proposed rule would apply to a systemically important insurance company designated by the Council under section 113 of the Dodd-Frank Act regardless of such a company’s asset size. Although the asset size of nonbank financial companies may not be the determinative factor of whether such companies may pose systemic risks and would be designated by the Council for supervision by the Board, it is an important consideration.<sup>32</sup> It is therefore unlikely that a financial firm that is at or below the \$38.5 million asset threshold for a life insurance carrier or below the 1,500 employee threshold for a property and casualty carrier would be designated by the Council under section 113 of the Dodd-Frank Act.

As noted above, because the proposed rule is not likely to apply to any life insurance carrier with assets of \$38.5 million or less or to any property and casualty carrier with less than 1,500 employees, if adopted in final form, it is not expected to apply to any small entity for purposes of the RFA. The

Board does not believe that the proposed rule duplicates, overlaps, or conflicts with any other Federal rules. In light of the foregoing, the Board does not believe that the proposed rule, if adopted in final form, would have a significant economic impact on a substantial number of small entities supervised. Nonetheless, the Board seeks comment on whether the proposed rule would impose undue burdens on, or have unintended consequences for, small organizations, and whether there are ways such potential burdens or consequences could be minimized in a manner consistent with section 165 of the Dodd-Frank Act.

#### List of Subjects

Administrative practice and procedure, Banks, banking, Holding companies, Reporting and recordkeeping requirements, Securities.

#### Authority and Issuance

For the reasons set forth in the preamble, chapter II of title 12 of the Code of Federal Regulations is amended as set forth below:

### PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)

- 1. The authority citation for part 252 continues to read as follows:

**Authority:** 12 U.S.C. 321–338a, 1467a(g), 1818, 1831p–1, 1844(b), 1844(c), 5361, 5365, 5366.

- 2. Add subpart P to read as follows:

#### Subpart P—Enhanced Prudential Standards for Systemically Important Insurance Companies

Sec.

- 252.160 Scope.
- 252.161 Applicability.
- 252.162 [Reserved]
- 252.163 Risk-management and risk committee requirements.
- 252.164 Liquidity risk-management requirements.
- 252.165 Liquidity stress testing and buffer requirements.

#### § 252.160 Scope.

This subpart applies to systemically important insurance companies. Unless otherwise specified, for purposes of this subpart, the term systemically important insurance company means a nonbank financial company that meets two requirements:

- (a) The Council has determined pursuant to section 113 of the Dodd-Frank Act that the company should be supervised by the Board and subjected to enhanced prudential standards; and
- (b) The company has 40 percent or more of its total consolidated assets

related to insurance activities as of the end of either of the two most recently completed fiscal years (systemically important insurance companies) or otherwise has been made subject to this subpart by the Board.

#### § 252.161 Applicability.

(a) *General applicability.* Subject to the initial applicability provisions of paragraph (b) of this section, a systemically important insurance company must comply with the risk-management and risk-committee requirements set forth in § 252.163 and the liquidity risk-management and liquidity stress test requirements set forth in §§ 252.164 and 252.165 beginning on the first day of the fifth quarter following the date on which the Council determined that the company shall be supervised by the Board.

(b) *Initial applicability.* A systemically important insurance company that is subject to supervision by the Board on the date that this rule was adopted by the Board must comply with the risk-management and risk-committee requirements set forth in § 252.163 and the liquidity risk-management and liquidity stress test requirements set forth in §§ 252.164 and 252.165, beginning on [date].

#### § 252.162 [Reserved].

#### § 252.163 Risk-management and risk committee requirements.

(a) *Risk committee*—(1) *General.* A systemically important insurance company must maintain a risk committee that approves and periodically reviews the risk-management policies of the systemically important insurance company’s global operations and oversees the operation of the systemically important insurance company’s global risk-management framework. The risk committee’s responsibilities include liquidity risk-management as set forth in § 252.164(b).

(2) *Risk-management framework.* The systemically important insurance company’s global risk-management framework must be commensurate with its structure, risk profile, complexity, activities, and size and must include:

(i) Policies and procedures establishing risk-management governance, risk-management procedures, and risk-control infrastructure for its global operations; and

(ii) Processes and systems for implementing and monitoring compliance with such policies and procedures, including:

(A) Processes and systems for identifying and reporting risks and risk-management deficiencies, including

<sup>31</sup> 13 CFR 121.201.

<sup>32</sup> See 76 FR 4555 (January 26, 2011).



regarding emerging risks, and ensuring effective and timely implementation of actions to address emerging risks and risk-management deficiencies for its global operations;

(B) Processes and systems for establishing managerial and employee responsibility for risk-management;

(C) Processes and systems for ensuring the independence of the risk-management function; and

(D) Processes and systems to integrate risk-management and associated controls with management goals and its compensation structure for its global operations.

(3) *Corporate governance requirements.* The risk committee must:

(i) Have a formal, written charter that is approved by the systemically important insurance company's board of directors;

(ii) Be an independent committee of the board of directors that has, as its sole and exclusive function, responsibility for the risk-management policies of the systemically important insurance company's global operations and oversight of the operation of the systemically important insurance company's global risk-management framework;

(iii) Report directly to the systemically important insurance company's board of directors;

(iv) Receive and review regular reports on not less than a quarterly basis from the systemically important insurance company's chief risk officer provided pursuant to paragraph (b)(2)(ii) of this section; and

(v) Meet at least quarterly, or more frequently as needed, and fully document and maintain records of its proceedings, including risk-management decisions.

(4) *Minimum member requirements.* The risk committee must:

(i) Include at least one member having experience in identifying, assessing, and managing risk exposures of large, complex financial firms; and

(ii) Be chaired by a director who:

(A) Is not an officer or employee of the systemically important insurance company and has not been an officer or employee of the systemically important insurance company during the previous three years;

(B) Is not a member of the immediate family, as defined in § 225.41(b)(3) of the Board's Regulation Y (12 CFR 225.41(b)(3)), of a person who is, or has been within the last three years, an executive officer of the systemically important insurance company, as defined in § 215.2(e)(1) of the Board's Regulation O (12 CFR 215.2(e)(1)); and

(C)(1) Is an independent director under Item 407 of the Securities and Exchange Commission's Regulation S-K (17 CFR 229.407(a)), if the systemically important insurance company has an outstanding class of securities traded on an exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) (national securities exchange); or

(2) Would qualify as an independent director under the listing standards of a national securities exchange, as demonstrated to the satisfaction of the Board, if the systemically important insurance company does not have an outstanding class of securities traded on a national securities exchange.

(b) *Chief risk officer—(1) General.* A systemically important insurance company must appoint a chief risk officer with experience in identifying, assessing, and managing risk exposures of large, complex financial firms.

(2) *Responsibilities.* (i) The chief risk officer is responsible for overseeing:

(A) The establishment of risk limits on an enterprise-wide basis and the monitoring of compliance with such limits;

(B) The implementation of and ongoing compliance with the policies and procedures set forth in paragraph (a)(2)(i) of this section and the development and implementation of the processes and systems set forth in paragraph (a)(2)(ii) of this section; and

(C) The management of risks and risk controls within the parameters of the insurance nonbank company's risk control framework, and monitoring and testing of the company's risk controls.

(ii) The chief risk officer is responsible for reporting risk-management deficiencies and emerging risks to the risk committee and resolving risk-management deficiencies in a timely manner.

(3) *Corporate governance requirements.* (i) The systemically important insurance company must ensure that the compensation and other incentives provided to the chief risk officer are consistent with providing an objective assessment of the risks taken by the systemically important insurance company; and

(ii) The chief risk officer must report directly to both the risk committee and chief executive officer of the company.

(c) *Chief actuary—(1) General.* A systemically important insurance company must appoint a chief actuary with the ability to assess and balance risk selection, pricing, and reserving issues across product lines and geographies. A systemically important

insurance company with significant life insurance business and property and casualty insurance business may appoint co-chief actuaries, one with responsibility for the company's life business and one with responsibility for the company's property and casualty business, in which case the below requirements would apply to each chief actuary.

(2) *Responsibilities.* (i) The chief actuary is responsible for determining on an enterprise-wide basis the adequacy of reserves and reviewing and advising senior management on the level of reserves.

(ii) The chief actuary is responsible for overseeing various activities, including but not limited to:

(A) Implementation of measures that assess the sufficiency of reserves;

(B) Review of the appropriateness of actuarial models, data, and assumptions used in reserving; and

(C) Implementation of and compliance with appropriate policies and procedures relating to actuarial work in reserving.

(iii) The systemically important insurance company must ensure that the compensation and other incentives provided to the chief actuary are consistent with providing an objective assessment of the systemically important insurance company's reserves.

(iv) The chief actuary must report directly to the audit committee of the company and may also have additional lines of reporting.

#### § 252.164 Liquidity risk-management requirements.

(a) *Responsibilities of the board of directors—(1) Liquidity risk tolerance.* The board of directors of a systemically important insurance company must:

(i) Approve the acceptable level of liquidity risk that the systemically important insurance company may assume in connection with its operating strategies (liquidity risk tolerance) at least annually, taking into account the systemically important insurance company's capital structure, risk profile, complexity, activities, and size; and

(ii) Receive and review at least semi-annually information provided by senior management to determine whether the systemically important insurance company is operating in accordance with its established liquidity risk tolerance.

(2) *Liquidity risk-management strategies, policies, and procedures.* The board of directors must approve and periodically review the liquidity risk-management strategies, policies, and procedures established by senior

management pursuant to paragraph (c)(1) of this section.

(b) *Responsibilities of the risk committee.* The risk committee (or a designated subcommittee of such committee composed of members of the board of directors) must approve the contingency funding plan described in paragraph (f) of this section at least annually, and must approve any material revisions to the plan prior to the implementation of such revisions.

(c) *Responsibilities of senior management—(1) Liquidity risk.* (i) Senior management of a systemically important insurance company must establish and implement strategies, policies, and procedures designed to effectively manage the risk that the systemically important insurance company's financial condition or safety and soundness would be adversely affected by its inability or the market's perception of its inability to meet its cash and collateral obligations (liquidity risk). The board of directors must approve the strategies, policies, and procedures pursuant to paragraph (a)(2) of this section.

(ii) Senior management must oversee the development and implementation of liquidity risk measurement and reporting systems, including those required by this section and § 252.165.

(iii) Senior management must determine at least quarterly whether the systemically important insurance company is operating in accordance with such policies and procedures and whether the systemically important insurance company is in compliance with this section and § 252.165 (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition warrant), and establish procedures regarding the preparation of such information.

(2) *Liquidity risk tolerance reporting.* Senior management must report to the board of directors or the risk committee regarding the systemically important insurance company's liquidity risk profile and liquidity risk tolerance at least quarterly (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition of the company warrant).

(3) *Business activities and products.*

(i) Before a systemically important insurance company offers a new product or initiates a new activity that could potentially materially adversely affect the designated insurer's liquidity, senior management must approve such product or activity after evaluating the liquidity costs, benefits, and risks associated with such product or activity. In determining whether to approve the new activity or product, senior

management must consider whether the liquidity risk of the new activity or product (under both current and stressed conditions) is within the company's established liquidity risk tolerance.

(ii) Senior management must review at least annually significant business activities and products to determine whether any activity or product creates or has created any unanticipated liquidity risk, and to determine whether the liquidity risk of each activity or product is within the company's established liquidity risk tolerance.

(4) *Cash-flow projections.* Senior management must review the cash-flow projections produced under paragraph (e) of this section at least quarterly (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition of the systemically important insurance company warrant) to ensure that the liquidity risk is within the established liquidity risk tolerance.

(5) *Liquidity risk limits.* Senior management must establish liquidity risk limits as set forth in paragraph (g) of this section and review the company's compliance with those limits at least quarterly (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition of the company warrant).

(6) *Liquidity stress testing.* Senior management must:

(i) Approve the liquidity stress testing practices, methodologies, and assumptions required in § 252.165(a) at least quarterly, and whenever the systemically important insurance company materially revises its liquidity stress testing practices, methodologies or assumptions;

(ii) Review the liquidity stress testing results produced under § 252.165(a) at least quarterly;

(iii) Review the independent review of the liquidity stress tests under paragraph (d) of this section periodically; and

(iv) Approve the size and composition of the liquidity buffer established under § 252.165(b) at least quarterly.

(d) *Independent review function.* (1) A systemically important insurance company must establish and maintain a review function to evaluate its liquidity risk-management.

(2) The independent review function must:

(i) Regularly, but no less frequently than annually, review and evaluate the adequacy and effectiveness of the company's liquidity risk-management processes, including its liquidity stress test processes and assumptions;

(ii) Assess whether the company's liquidity risk-management function complies with applicable laws, regulations, supervisory guidance, and sound business practices;

(iii) Report material liquidity risk-management issues to the board of directors or the risk committee in writing for corrective action, to the extent permitted by applicable law; and

(iv) Be independent of management functions that execute funding.

(e) *Cash-flow projections.* (1) A systemically important insurance company must produce comprehensive cash-flow projections that project cash flows arising from assets, liabilities, and off-balance sheet exposures over, at a minimum, short- and long-term time horizons, including time horizons longer than one year. The systemically important insurance company must update short-term cash-flow projections daily and must update longer-term cash-flow projections at least monthly.

(2) The systemically important insurance company must establish a methodology for making cash-flow projections that results in projections that:

(i) Include cash flows arising from anticipated claim and annuity payments; policyholder options including surrenders, withdrawals, and policy loans; intercompany transactions; premiums on new and renewal business; expenses; maturities and renewals of funding instruments, including through the operation of any provisions that could accelerate the maturity; investment income and proceeds from assets sales; and other potential liquidity exposures;

(ii) Include reasonable assumptions regarding the future behavior of assets, liabilities, and off-balance sheet exposures;

(iii) Identify and quantify discrete and cumulative cash flow mismatches over these time periods; and

(iv) Include sufficient detail to reflect the capital structure, risk profile, complexity, currency exposure, activities, and size of the systemically important insurance company, and any applicable legal and regulatory requirements, and include analyses by business line, currency, or legal entity as appropriate.

(3) The systemically important insurance company must adequately document its methodology for making cash flow projections and the included assumptions.

(f) *Contingency funding plan.* (1) A systemically important insurance company must establish and maintain a contingency funding plan that sets out the company's strategies for addressing

liquidity needs during liquidity stress events and describes the steps that should be taken to ensure that the systemically important insurance company's sources of liquidity are sufficient to fund its normal operating requirements under stress events. To operate normally, a firm must have sufficient funding to pay obligations in the ordinary course as they become due and meet all solvency requirements for the writing of new and renewal policies. The contingency funding plan must be commensurate with the company's capital structure, risk profile, complexity, activities, size, and established liquidity risk tolerance. The company must update the contingency funding plan at least annually, and when changes to market and idiosyncratic conditions warrant.

(2) *Components of the contingency funding plan*—(i) Quantitative assessment. The contingency funding plan must:

(A) Identify liquidity stress events that could have a significant impact on the systemically important insurance company's liquidity;

(B) Assess the level and nature of the impact on the systemically important insurance company's liquidity that may occur during identified liquidity stress events;

(C) Identify the circumstances in which the systemically important insurance company would implement its action plan described in paragraph (f)(2)(ii)(A) of this section, which circumstances must include failure to meet any minimum liquidity requirement imposed by the Board;

(D) Assess available funding sources and needs during the identified liquidity stress events;

(E) Identify alternative funding sources that may be used during the identified liquidity stress events; and

(F) Incorporate information generated by the liquidity stress testing required under § 252.165(a).

(ii) *Liquidity event management process*. The contingency funding plan must include an event management process that sets out the systemically important insurance company's procedures for managing liquidity during identified liquidity stress events. The liquidity event management process must:

(A) Include an action plan that clearly describes the strategies the company will use to respond to liquidity shortfalls for identified liquidity stress events, including the methods that the company will use to access alternative funding sources;

(B) Identify a liquidity stress event management team that would execute

the action plan described in paragraph (f)(2)(ii)(A) of this section;

(C) Specify the process, responsibilities, and triggers for invoking the contingency funding plan, describe the decision-making process during the identified liquidity stress events, and describe the process for executing contingency measures identified in the action plan; and

(D) Provide a mechanism that ensures effective reporting and communication within the systemically important insurance company and with outside parties, including the Board and other relevant supervisors, counterparties, and other stakeholders.

(iii) *Monitoring*. The contingency funding plan must include procedures for monitoring emerging liquidity stress events. The procedures must identify early warning indicators that are tailored to the company's capital structure, risk profile, complexity, activities, and size.

(3) *Testing*. The systemically important insurance company must periodically test:

(i) The components of the contingency funding plan to assess the plan's reliability during liquidity stress events;

(ii) The operational elements of the contingency funding plan, including operational simulations to test communications, coordination, and decision-making by relevant management; and

(iii) The methods the systemically important insurance company will use to access alternative funding sources to determine whether these funding sources will be readily available when needed.

(g) *Liquidity risk limits*—(1) *General*. A systemically important insurance company must monitor sources of liquidity risk and establish limits on liquidity risk, including limits on:

(i) Concentrations in sources of funding by instrument type, single counterparty, counterparty type, secured and unsecured funding, and as applicable, other forms of liquidity risk;

(ii) Potential sources of liquidity risk arising from insurance liabilities;

(iii) The amount of non-insurance liabilities that mature within various time horizons; and

(iv) Off-balance sheet exposures and other exposures that could create funding needs during liquidity stress events.

(2) *Size of limits*. Each limit established pursuant to paragraph (g)(1) of this section must be consistent with the company's established liquidity risk tolerance and must reflect the

company's capital structure, risk profile, complexity, activities, and size.

(h) *Collateral, legal entity, and intraday liquidity risk monitoring*. A systemically important insurance company must establish and maintain procedures for monitoring liquidity risk as set forth in this paragraph.

(1) *Collateral*. The systemically important insurance company must establish and maintain policies and procedures to monitor assets that have been, or are available to be, pledged as collateral in connection with transactions to which it or its affiliates are counterparties. These policies and procedures must provide that the systemically important insurance company:

(i) Calculates all of its collateral positions on a weekly basis (or more frequently, as directed by the Board), specifying the value of pledged assets relative to the amount of security required under the relevant contracts and the value of unencumbered assets available to be pledged;

(ii) Monitors the levels of unencumbered assets available to be pledged by legal entity, jurisdiction, and currency exposure;

(iii) Monitors shifts in the systemically important insurance company's funding patterns, such as shifts in the tenor of obligations and collateral requirements; and

(iv) Tracks operational and timing requirements associated with accessing collateral at its physical location (for example, the custodian or securities settlement system that holds the collateral).

(2) *Legal entities, currencies, and business lines*. The systemically important insurance company must establish and maintain procedures for monitoring and controlling liquidity risk exposures and funding needs within and across significant legal entities, currencies, and business lines, taking into account legal and regulatory restrictions on the transfer of liquidity between legal entities.

(3) *Intraday exposures*. The systemically important insurance company must establish and maintain procedures for monitoring the intraday liquidity risk exposure of the systemically important insurance company if necessary for its business. If applicable, these procedures must address how the management of the systemically important insurance company will:

(i) Monitor and measure expected daily gross liquidity inflows and outflows;

(ii) Identify and prioritize time-specific obligations so that the

systemically important insurance company can meet these obligations as expected and settle less critical obligations as soon as possible;

(iii) Coordinate the purchase and sale of derivatives so as to maximize the effectiveness of their hedging programs;

(iv) Consider the amounts of collateral and liquidity needed to meet obligations when assessing the systemically important insurance company's overall liquidity needs; and

(v) Where necessary, manage and transfer collateral to obtain intraday credit.

**§ 252.165 Liquidity stress testing and requirements.**

*(a) Liquidity stress testing requirement—(1) General.*

A systemically important insurance company must conduct stress tests to assess the potential impact of the liquidity stress scenarios set forth in paragraph (a)(3) of this section on its cash flows, liquidity position, profitability, and solvency, taking into account its current liquidity condition, risks, exposures, strategies, and activities.

(i) The systemically important insurance company must take into consideration its balance sheet exposures, off-balance sheet exposures, size, risk profile, complexity, business lines, organizational structure, and other characteristics of the systemically important insurance company that affect its liquidity risk profile in conducting its stress test. Mechanisms that would imperil a systemically important insurance company's ability to continue operations—such as contractual stays—should not be taken into consideration as a source of liquidity in stress testing.

(ii) In conducting a liquidity stress test using the scenarios described in paragraph (a)(3) of this section, the systemically important insurance company must address the potential direct adverse impact of associated market disruptions on the systemically important insurance company and incorporate the potential actions of other market participants experiencing liquidity stresses, contract holders, and policyholders under the market disruptions that would adversely affect the systemically important insurance company.

(2) *Frequency.* The liquidity stress tests required under paragraph (a)(1) of this section must be performed at least monthly. The Board may require the systemically important insurance company to perform stress testing more frequently.

(3) *Stress scenarios.* (i) Each liquidity stress test conducted under paragraph

(a)(1) of this section must include, at a minimum:

(A) A scenario reflecting adverse market conditions;

(B) A scenario reflecting an idiosyncratic stress event for the systemically important insurance company; and

(C) A scenario reflecting combined market and idiosyncratic stresses.

(ii) The systemically important insurance company must incorporate additional liquidity stress scenarios into its liquidity stress test, as appropriate, based on its financial condition, size, complexity, risk profile, scope of operations, or activities. The Board may require the systemically important insurance company to vary the underlying assumptions and stress scenarios.

(4) *Planning horizon.* Each stress test conducted under paragraph (a)(1) of this section must include a seven-day planning horizon, a 30-day planning horizon, a 90-day planning horizon, a one-year planning horizon, and any other planning horizons that are relevant to the systemically important insurance company's liquidity risk profile. For purposes of this section, a "planning horizon" is the period over which the relevant stressed projections extend. The systemically important insurance company must use the results of the stress test over the 90-day planning horizon to calculate the size of the liquidity buffer under paragraph (b) of this section.

(5) *Requirements for assets used as cash-flow sources in a stress test.* (i) To the extent an asset is used as a cash-flow source to offset projected funding needs during the planning horizon in a liquidity stress test, the fair market value of the asset must be discounted to reflect any credit risk and market volatility of the asset.

(ii) Assets used as cash-flow sources during a planning horizon must be diversified by collateral, counterparty, borrowing capacity, and other factors associated with the liquidity risk of the assets.

(iii) For stress tests with a planning horizon of 90 days or less, cash-flow sources cannot include future borrowings or the liquidation of assets unless they meet the requirement to be part of the buffer as defined in (b)(3) of this section. In all stress tests and notwithstanding the limitations on asset liquidity, separate account assets and closed block assets would be permitted to be included as cash-flow sources in proportion to the cash flow needs in these same accounts.

(6) *Tailoring.* Stress testing must be tailored to, and provide sufficient detail

to reflect, a systemically important insurance company's capital structure, risk profile, complexity, activities, and size.

(7) *Governance—(i) Policies and procedures.* A systemically important insurance company must establish and maintain policies and procedures governing its liquidity stress testing practices, methodologies, and assumptions that provide for the incorporation of the results of liquidity stress tests in future stress testing and for the enhancement of stress testing practices over time.

(ii) *Controls and oversight.* A systemically important insurance company must establish and maintain a system of controls and oversight that is designed to ensure that its liquidity stress testing processes are effective in meeting the requirements of this section. The controls and oversight must ensure that each liquidity stress test appropriately incorporates conservative assumptions with respect to the stress scenario in paragraph (a)(3) of this section and other elements of the stress-test process, taking into consideration the systemically important insurance company's capital structure, risk profile, complexity, activities, size, business lines, legal entity or jurisdiction, and other relevant factors. The assumptions must be approved by the chief risk officer and be subject to the independent review under § 252.164(d).

(iii) *Management information systems.* The systemically important insurance company must maintain management information systems and data processes sufficient to enable it to effectively and reliably collect, sort, and aggregate data and other information related to liquidity stress testing.

(b) *Liquidity buffer requirement.* (1) A systemically important insurance company must maintain a liquidity buffer that is sufficient to meet the projected net stressed cash-flow need over the 90-day planning horizon of a liquidity stress test conducted in accordance with paragraph (a) of this section under each scenario set forth in paragraph (a)(3) of this section.

(2) *Net stressed cash-flow need.* The net stressed cash-flow need for a systemically important insurance company is the difference between the amount of its cash-flow need and the amount of its cash flow sources over the 90-day planning horizon.

(3) *Asset requirements.* The liquidity buffer must consist of highly liquid assets that are unencumbered, as defined in paragraph (b)(3)(ii) of this section:

(i) *Highly liquid asset.* A highly liquid asset includes:

(A) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;

(B) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of the Treasury) whose obligations are fully and explicitly guaranteed by the full faith and credit of the U.S. government provided that the security is liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section;

(C) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, European Community, or a multilateral development bank, that is:

(i) Either:

(A) Assigned no higher than a 20 percent risk weight under subpart D of Regulation Q (12 CFR part 217); or

(B) Issued by a sovereign entity in its own currency and the systemically important insurance company holds the security in order to meet its net cash outflows in the jurisdiction of the sovereign entity;

(ii) Liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section;

(iii) Issued or guaranteed by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions; and

(iv) Not an obligation of a financial sector entity and not an obligation of a consolidated subsidiary of a financial sector entity;

(D) A security issued by, or guaranteed as to the timely payment of principal and interest by, a U.S. government sponsored enterprise, that is investment grade under 12 CFR part 1 as of the calculation date, provided that the claim is senior to preferred stock and liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section;

(E) A corporate debt security that is:

(i) Liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section

(ii) Investment grade under 12 CFR part 1 as of the calculation date;

(iii) Issued or guaranteed by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions; and

(iv) Not an obligation of a financial sector entity and not an obligation of a

consolidated subsidiary of a financial sector entity; or

(F) A publicly traded common equity share that is:

(i) Liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section;

(ii) Included in: The Russell 1000 Index;

(iii) Issued by an entity whose publicly traded common equity shares have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions;

(iv) Not issued by a financial sector entity and not issued by a consolidated subsidiary of a financial sector entity; and

(v) If held by a depository institution, is not acquired in satisfaction of a debt previously contracted (DPC);

(G) A general obligation security issued by, or guaranteed as to the timely payment of principal and interest by, a public sector entity where the security is:

(i) Liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section;

(ii) Investment grade under 12 CFR part 1 as of the calculation date;

(iii) Issued or guaranteed by a public sector entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions; and

(iv) Not an obligation of a financial sector entity and not an obligation of a consolidated subsidiary of a financial sector entity, except that a security will not be disqualified as a highly liquid asset solely because it is guaranteed by a financial sector entity or a consolidated subsidiary of a financial sector entity if the security would, if not guaranteed, meet the criteria of this section.

(H) Any other asset that the systemically important insurance company demonstrates to the satisfaction of the Board:

(1) Has low credit risk and low market risk;

(2) Liquid and readily-marketable, as defined in paragraph (b)(3)(iii) of this section and

(3) Is a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity has been impaired.

(ii) *Unencumbered*. An asset is unencumbered if it:

(A) Is free of legal, regulatory, contractual, or other restrictions on the ability of such systemically important insurance company promptly to liquidate, sell or transfer the asset; and

(B) Is not pledged or used to secure or provide credit enhancement to any transaction.

(iii) *Liquid and readily marketable*. Liquid and readily-marketable means, with respect to a security, that the security is traded in an active secondary market with:

(1) More than two committed market makers;

(2) A large number of non-market maker participants on both the buying and selling sides of transactions;

(3) Timely and observable market prices; and

(4) A high trading volume.

(iv) *Limitations on intra-group transfer of funds*. Insurance non-bank financial companies must hold enough highly liquid, unencumbered assets at the top-tier holding company to cover the sum of all stand-alone material entity net liquidity deficits. The stand-alone net liquidity deficit of each material entity would be calculated as that entity's amount of net stressed outflows over a 90-day planning horizon less the highly liquid assets held at the material entity. For the purposes of evaluating liquidity deficits of material entities, systemically important insurance companies should treat inter-affiliate exposures in the same manner as third-party exposures. The remaining highly liquid, unencumbered assets that are held to satisfy the liquidity buffer requirement can be held at a regulated company up to:

(A) The average amount of net cash outflows of the company holding the assets during the 90-day planning horizon in the scenarios set forth in paragraph (a)(3) plus.

(B) Any additional amount of assets, including proceeds from the monetization of assets that would be available for transfer to the top-tier company during times of stress without statutory, regulatory, contractual, or supervisory restrictions.

(v) *Calculating the amount of a highly liquid asset*. In calculating the amount of a highly liquid asset included in the liquidity buffer, the systemically important insurance company must discount the fair market value of the asset to reflect any credit risk and market price volatility of the asset.

(vi) *Diversification*. The liquidity buffer must not contain significant concentrations of highly liquid assets by issuer, business sector, region, or other factor related to the systemically important insurance company's risk, except with respect to cash and securities issued or guaranteed by the United States, a U.S. government agency, or a U.S. government-sponsored enterprise.

By order of the Board of Governors of the Federal Reserve System, June 9, 2016.

**Robert deV. Frierson,**  
Secretary of the Board.

[FR Doc. 2016-14005 Filed 6-13-16; 8:45 am]

BILLING CODE 6210-01-P

## FEDERAL RESERVE SYSTEM

### 12 CFR Chapter II

[Docket No. R-1539]

RIN 7100 AE 53

#### Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Advance notice of proposed rulemaking.

**SUMMARY:** The Board of Governors of the Federal Reserve System (Board) is inviting comment on an advance notice of proposed rulemaking (ANPR) regarding approaches to regulatory capital requirements for depository institution holding companies significantly engaged in insurance activities (insurance depository institution holding companies), and nonbank financial companies that the Financial Stability Oversight Council (FSOC or Council) has determined will be supervised by the Board and that have significant insurance activities (systemically important insurance companies). The Board is inviting comment on two approaches to consolidated capital requirements for these institutions: An approach that uses existing legal entity capital requirements as building blocks for insurance depository institution holding companies and a simple consolidated approach for systemically important insurance companies.

**DATES:** Comments must be received no later than August 17, 2016.

**ADDRESSES:** You may submit comments, identified by Docket No. R-1539; RIN 7100 AE 53, by any of the following methods:

- *Agency Web site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Email:* [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include Docket No. R-1539; RIN 7100 AE 53 in the subject line of the message.
- *Fax:* (202) 452-3819 or (202) 452-3102.

- *Mail:* Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room 3515, 1801 K Street NW., (between 18th and 19th Streets NW.), Washington, DC 20006 between 9:00 a.m. and 5:00 p.m. on weekdays. For security reasons, the Board requires that visitors make an appointment to inspect comments. You may do so by calling (202) 452-3684. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

**FOR FURTHER INFORMATION CONTACT:**

Thomas Sullivan, Associate Director, (202) 475-7656, Linda Duzick, Manager, (202) 728-5881, or Suyash Paliwal, Senior Insurance Policy Analyst, (202) 974-7033, Division of Banking Supervision and Regulation; or Laurie Schaffer, Associate General Counsel, (202) 452-2272, Benjamin W. McDonough, Special Counsel, (202) 452-2036; Tate Wilson, Counsel, (202) 452-369; David Alexander, Counsel, (202) 452-2877; or Mary Watkins, Attorney (202) 452-3722, Legal Division.

**SUPPLEMENTARY INFORMATION:**

#### I. Introduction

##### A. Background

Robust capital is an important safeguard to protect the safety and soundness of financial institutions; enhance the resilience of financial institutions to position them to better navigate periods of financial or economic stress; and mitigate threats to financial stability that might be posed by the activities, material financial distress, or failure of financial institutions. To help achieve these benefits, various provisions of Federal law require the Board and other Federal banking agencies to establish minimum capital standards for holding companies that own insured depository institutions (IDIs) and for financial firms that are designated by the FSOC for supervision by the Board. The capital standards developed by the Board take into account the overall risk profile and the

size, scope, and complexity of the operations of the institution. Further, the law allows the Board to tailor the minimum capital requirements applicable to companies that both own an IDI and significantly engage in insurance activities as well as for systemically important insurance companies.

The Board's supervisory objectives in setting capital requirements for the consolidated institution focus on the safety and soundness of the company and its IDI and on enhancing financial stability, and complement the primary mission of state legal entity insurance supervisors, which tends to focus on the protection of policyholders.<sup>1</sup> To achieve these objectives, the Board seeks comment on several approaches to designing a regulatory capital framework for supervised institutions significantly engaged in insurance activities that is intended to ensure that the institution has sufficient capital, commensurate with its overall institution-wide risk profile (1) to absorb losses and continue operations as a going concern throughout times of economic, financial, and insurance-related stress (e.g., morbidity, mortality, longevity, natural and man-made catastrophes); (2) to serve as a source of strength to any subsidiary depository institutions;<sup>2</sup> and (3) to substantially mitigate any threats to financial stability that the institution might pose.

#### B. The Board's Consolidated Supervision of Systemically Important Insurance Companies and Insurance Depository Institution Holding Companies

This ANPR seeks comment on proposed approaches to regulatory capital requirements that are tailored to the risks of supervised insurance institutions, including both insurance depository institution holding companies and systemically important insurance companies.

The Board has broad authority to establish regulatory capital standards for

<sup>1</sup> For discussion regarding state supervision of insurance, see, e.g., Financial Stability Oversight Council, Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc. (July 8, 2013), available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf>; Financial Stability Oversight Council, Basis of the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013), available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Prudential%20Financial%20Inc.pdf>.

<sup>2</sup> 12 U.S.C. 1831o-1. See also, 12 U.S.C. 1844 and Section 706, Division O, of the Consolidated Appropriations Act, 2016, Public Law 114-113, 129 Stat. 2242 (2015).