AMERICAN ACADEMY of ACTUARIES

July 27, 2023

Financial Stability Oversight Council (FSOC)
U.S. Department of the Treasury

Re: Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies Proposal

To Whom It May Concern:

The American Academy of Actuaries[1] Prudential Regulation Committee appreciates the opportunity to comment on the Authority to Require Supervision and Regulations of Certain Nonbank Financial Companies.

Regarding the guidance overall, with respect to insurance entities, there are a wide range of existing assessment tools regarding the potential for material financial distress. We strongly agree with the commentary about working closely with existing regulators and their analysis and metrics. For example, the existing statutory risk-based capital regime is designed to identify weakly capitalized companies, and is a fundamentally useful metric to identify the likelihood of material financial distress to individual companies and to effectively oversee and effect the sustainable resolutions of any failures without government financial assistance.

Regarding the specific questions asked, our feedback is as follows (note that for questions not listed below, we have no comments):

5. Are there additional steps the Council should take to ensure all of its authorities for addressing potential risks to U.S. financial stability are equally available and appropriately exercised?

We recommend that the Council also include consideration of how a firm's risk mitigation activities address its risk exposures to the divergent impacts of liquidity, long-term needs for capital, and systemic operational risks.

6. Would the proposed staff-level process for identifying nonbank financial companies for preliminary evaluation enable the Council to achieve its statutory purposes? Does the Proposed Guidance identify the appropriate procedures the Council should follow as it considers a company for potential designation? Are there other means of identifying companies for preliminary review the Council should consider, such as the application of specific metrics for different sectors of the nonbank financial system?

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

We note that while Appendix A includes a lot of detail about the evaluation process, it is not very specific regarding the approach to identify a set of financial institutions that will be evaluated. The exposure notes that "During the first stage of the process (Stage 1), a nonbank financial company identified for review will be notified and subject to a preliminary analysis, based on quantitative and qualitative information available to the Council primarily through public and regulatory sources." It is not clear how a nonbank financial company will be "identified for review." We understand that the monitoring of the sector by a staff-level committee will be one input to this process, but we suggest outlining more specific and objective measures that may be used in the identification process for a Stage 1 review. Use of such measures promotes transparency and a risk-based identification process. We also suggest that this identification process leverage the work of primary regulators, where such measures are already in place.

7. If the Council were to establish a set of uniform quantitative metrics to identify nonbank financial companies for further evaluation, as it did through the Stage 1 thresholds in the 2012 Interpretive Guidance, what metrics should the Council consider?

For insurance entities, one readily available potential metric suggested for use is the risk-based capital ratio, although this metric is more focused on the ability to meet all obligations over time and not the risk of an inability to meet cash demands in the short term. This metric also is for individual legal entities and does not reflect any support from other members of an insurance group. In addition, we recognize that it is not uniform across all nonbank financial companies, only those in the insurance sector. Lastly, the metrics need to be specific to the unique risk stresses of the range of possibly very diverse services and interconnectedness provided by nonbank financial companies.

We would be glad to respond to any proposals of such metrics and/or assist in their thoughtful development.

10. What data or factors should the Council consider in evaluating the potential risk to U.S. financial stability that could be posed by the failure of a company, should that company experience material financial distress?

We believe that the following information may assist the Council in evaluating potential risk to U.S. financial stability:

- *Third-party agreements/guarantees with other firms (to evaluate the extent of interconnectedness),*
- *Sufficiency of existing reserves and capital to cover obligations (to evaluate the likelihood of not being able to make payments to customers or counterparties),*
- *Maturity profile of assets as compared to cash demands (to evaluate the likelihood of not being able to make near-term payments to customers or counterparties)*

11. If the Council were to identify a nonbank financial company as likely to experience material financial distress, what, if any, effects would such identification have when it became public knowledge?

We believe that public identification might trigger the following:

- *Impact on ratings;*
- *Cash demands in third-party agreements (for example, if they are triggered by ratings);*
- *Increased lapses by policyholders or customers; and/or*
- *Inability to access contingent capital or contingent liquidity sources.*

We recommend that if the Council eliminated the likelihood assessment as part of the designation process, it be included as part of the risk assessment process within the analytical framework to avoid placing inappropriate weight on speculative outcomes with low likelihood.

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The Academy's Prudential Regulation Committee is available to provide additional input as this exposure is considered. Please contact Devin Boerm, the Academy's director of public policy (boerm@actuary.org), with any questions.

Sincerely,

Patricia Matson, MAAA, FSA
Chairperson, Prudential Regulation Committee
American Academy of Actuaries