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March 23, 2015

Mr. Patrick Pinschmidt
Deputy Assistant Secretary
Financial Stability Oversight Council
1500 Pennsylvania Ave., NW
Washington, DC 20220
Via http://www.regulations.gov

RE: *Notice Seeking Comment on Asset Management Products and Activities* [Docket Number FSOC-2014-0001]

Dear Deputy Assistant Secretary Pinschmidt,

On behalf of the American Academy of Actuaries'[1] Financial Regulatory Task Force, I would like to thank the Financial Stability Oversight Council (FSOC) for the opportunity to provide comments on the Dec. 18, 2014, *Notice Seeking Comment on Asset Management Products and Activities*. The U.S actuarial profession is committed to helping regulators and legislators improve U.S. financial stability. Actuaries' unique qualifications from their extensive education, experience measuring and managing risk, and the highest professional standards enable them to offer objective feedback on the actuarial soundness of laws, regulations, guidance, and other proposals to policymakers. To that end, the task force would like to provide an actuarial perspective on the potential impact on U.S. financial stability of asset management products and activities as they relate to insurance.

Insurance asset management products are fundamentally different than those of other financial institutions, particularly banks. The task force urges the FSOC to treat them as such as it examines the impact of asset management products and activities on U.S. financial stability.

Insurance company "separate accounts" maintain policyholder assets in portfolios that are segregated from the insurance company's general account. As highlighted in footnote 11 of the *Notice Seeking Comment on Asset Management Products and Activities*, separate accounts are recognized under the Investment Company Act as unit investment trusts. Usually, they are invested as directed by the policyholder or according to specified investment guidelines, which may differ from how the general account assets are invested. Separate accounts also typically are insulated from claims on insurance company assets in the event of insolvency, and the

[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists 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.

policyholder bears the investment risk associated with the performance of the separate account assets. That is, separate account investment returns, whether positive or negative, commonly are passed to the policyholder.

Risk to the insurer tends to arise through guarantees provided in conjunction with the separate account. These risks include mortality/longevity, policyholder behavior, equity, interest rate, credit, among others. Separate account insurance products may offer minimum guarantees for death benefits, living benefits, or returns of account value if certain conditions are met. The nature of the guarantees could affect the range of permissible separate account investments available to policyholders. For instance, if the insurance company provides guaranteed living benefits under the separate account insurance policy, the policyholder may not be able to direct his or her account values to more risky separate account investment options. General account benefit reserves are established to provide for these guarantees, and assets backing the reserves are held in the insurer's general account.

Insurance products, particularly those discussed above, typically are subject to reduced redemption, or "run on the bank," risks to which other financial institutions are subject, for several reasons:

- Most insurance contracts allow the company to delay payment of surrender benefits for up to six months.

- Under the National Association of Insurance Commissioners' (NAIC) *Risk Based Capital (RBC) for Insurers Model Act*, when a company becomes "troubled" or "insolvent," state regulators are permitted to take control of the company's assets, monitor the sale or purchase of assets, change the mix of the company's asset portfolio, and sell certain assets in order to stabilize the insurer.[2] Twenty-six states have adopted the model act. The other 24 states and the District of Columbia have adopted similar legislative measures. In addition, all insurers are required by state law to be members of insurance guarantee associations, overseen by a board of directors and the relevant state insurance regulator.[3] If an insolvent insurer is unable to pay policyholder claims, the guarantee association will utilize an assessment from insurance companies doing similar business—up to a statutory limit that varies among states—and the insolvent insurer's assets to pay them.[4]

- Insurance products contain contractual features that deter surrender, such as early surrender penalties. Policyholders would forfeit valuable policy benefits and guarantees upon surrender. In many cases, the same type or level of guarantee may no longer be available, or changes in age or other aspects of insurability may adversely impact the value of replacement insurance coverage available to the individual.

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[2] "Risk Based Capital (RBC) for Insurers Model Act," NAIC, January 2012, http://www.naic.org/store/free/MDL-312.pdf.
[3] "Guaranty Associations," NAIC and the Center for Insurance Policy and Research, January 2015, http://www.naic.org/cipr_topics/topic_guaranty_associations.htm.
[4] Ibid.

- Existing gains in the insurance contract would be taxable in the event of surrender. Therefore, it is in the long- and short-term interest of the policyholder to maintain insurance coverage through economic cycles.

While future financial crises may have different characteristics, U.S. insurers did not experience pronounced increases in surrenders during the recent financial crisis. The factors cited above appear to have been effective in limiting redemption requests from insurance company separate accounts.

Assets backing insurance company liabilities and capital are monitored by functional state insurance regulators. Insurance company insolvencies are rare. When they do occur, they tend to be resolved over a long time period so as to run off the long-term assets and liabilities of the insurer and fulfill covered benefits. Out of the 28 life and health insurers that went into receivership with state insurance regulators in the past 15 years, only four have actually been closed or liquidated.[5]

Some insurance groups have third-party asset management activities that are separate and distinct from the insurer's insurance activities, including the management of assets in the general account.[6] These activities typically occur in investment management subsidiaries in insurance holding companies, which are legally separate from insurance company entities. They are, and presumably will continue to be, regulated as investment advisory organizations.

Furthermore, the leverage section of the notice refers to derivatives. The task force does not believe that the leverage section directly pertains to insurance company usage of derivatives. Insurance companies use them for risk management purposes to hedge corresponding policyholder liabilities. Their use for speculative purposes is strictly limited, regulated, and monitored by state insurance regulators. We encourage the FSOC to consider the distinction between the use of derivatives for risk management purposes versus those used for leverage in any determinations it makes on asset management activities and products.

The distinguishing features of insurance separate account products have been effective in mitigating company liquidity risk. Insurance separate account products do not pose the same risk to financial stability as other asset management products. The FSOC should consider these products separately from other asset management products within any policymaking recommendations or systemically important financial institution deliberations by the FSOC.

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Thank you for this opportunity to provide input on the potential impact of asset management products and activities on U.S. financial stability as it relates to insurance. If you have any questions or would like to discuss these issues in more detail, please contact Lauren Sarper, the

[5] "Impairments & Insolvencies," Facts and Figures, National Organization of Life & Health Insurance Guaranty Associations, 2015, https://www.nolhga.com/factsandfigures/main.cfm/location/insolvencies/orderby/date#sort.

[6] The management of the assets in the insurer's general account is not separate from the insurance activities.

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Sincerely,

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