Meeting between Federal Reserve Board Staff and Representatives of the American Council of Life Insurers and Financial Services Roundtable Working Group
February 16, 2012

Participants: Scott Alvarez, Anna Harrington, James O'Brien and Christopher Paridon (Federal Reserve Board)

Julie Spezio (American Council of Life Insurers); James Fifield, Peter Freeman, Julia Lawler-Johnson, and Rosa Riddle (Financial Services Roundtable Working Group); Sean Cassidy and Gerald Lins (ING); William Ding and Michael Mazzola (MetLife); Chris Black, Bridget Hagan and Harry Hallowell (Nationwide); John Bronson, Sheila Greenwood, and Michael Long (Prudential); Molly Wilkinson (Regions); Byron Anderson (Transamerica); Paul Lee and Samuel Proctor (Debevoise & Plimpton LLP)

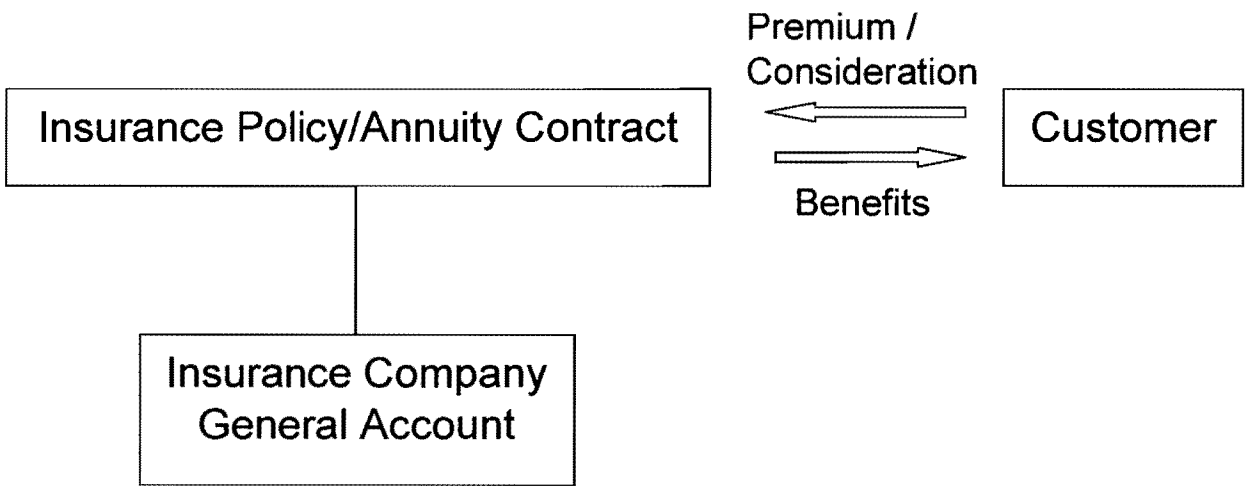
Summary: Staff of the Federal Reserve Board met with representatives and members of the American Council of Life Insurers ("ACLI") and Financial Services Roundtable Working Group ("FSRWG") to discuss the restrictions on proprietary trading and hedge fund and private equity fund activities under section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (also known as the "Volcker Rule").

Among matters discussed in the meeting were the ACLI and FSRWG's views regarding the proposed rule's implementation of the statutory exemption related to activities of insurance companies in light of the necessity for insurance companies to match long-term liabilities with long-term assets. Their principal recommendation was that the final rule should be modified so that the exemption for certain insurance company activities applies not only to the prohibition of proprietary trading but also to the prohibition on covered fund activities and investments. They noted their views that the Volcker Rule is intended to accommodate all aspects of the business of insurance, a narrow interpretation of the Volcker Rule (similar to that contained in the proposed rule) would pose a very substantial impediment to the business of insurance, and that state insurance laws have developed to regulate the business of insurance, including through promoting diversification of investments by insurance companies in alternative asset classes such as hedge funds and private equity funds.

The ACLI and FSRWG representatives also commented that the proposed rule's definition of "separate account" should be either modified or clarified to encompass "hybrid accounts" and all types of variable separate accounts where not all the profits or losses of the account inure to the benefit or detriment of customers, in many instances due to the existence of guarantees from the general account. The ACLI and FSRWG representatives also noted that unregistered separate accounts may rely on sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 and consequently could be captured as covered funds. In their view, as such accounts are not "sponsored" by the insurance company (as that term is used in the Volcker Rule), they should not be subject to the restrictions on covered funds. In the alternative, the ACLI representatives suggested that these accounts be treated in the same manner as bank owned life insurance is treated under the proposed rule.

The ACLI and FSRWG representatives also provided the attachment and referenced their comment letter to the Board.

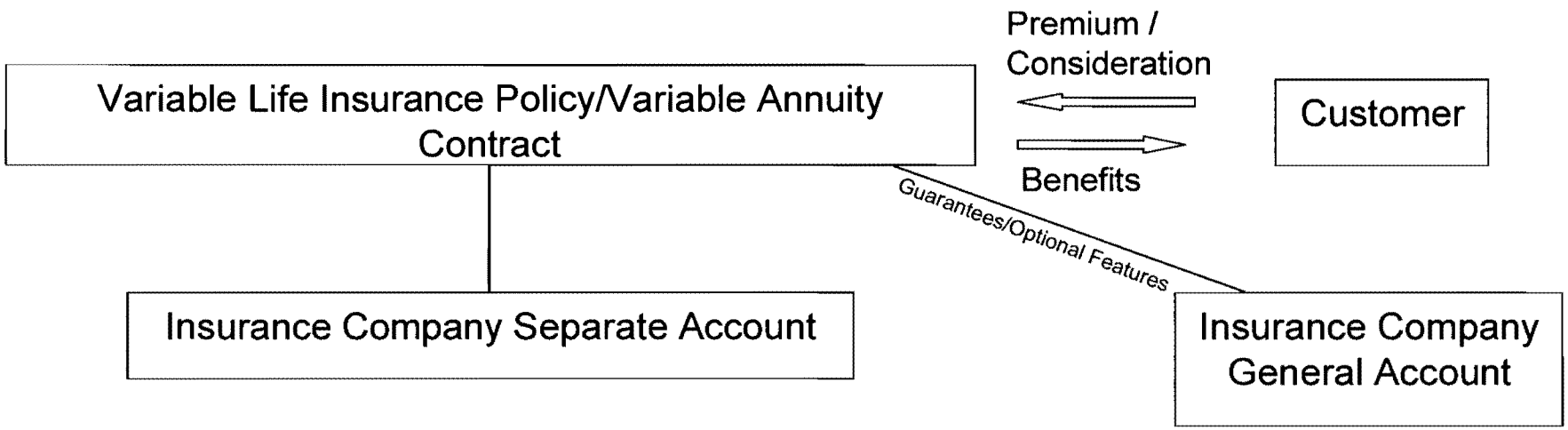
Life Insurance Company General Account Structure



- Customer can be institutional or retail.
- Insurance policy can cover risks such as death, accident, long term disability. Annuity contract generally provides accumulation of principal and income stream as agreed in contract.
- General account assets support insurance policy/annuity contract and all other general liabilities of the insurance company. Assets must be invested in accordance with general account investment laws.

Note: these illustrations are generic and subject to state laws, which vary.

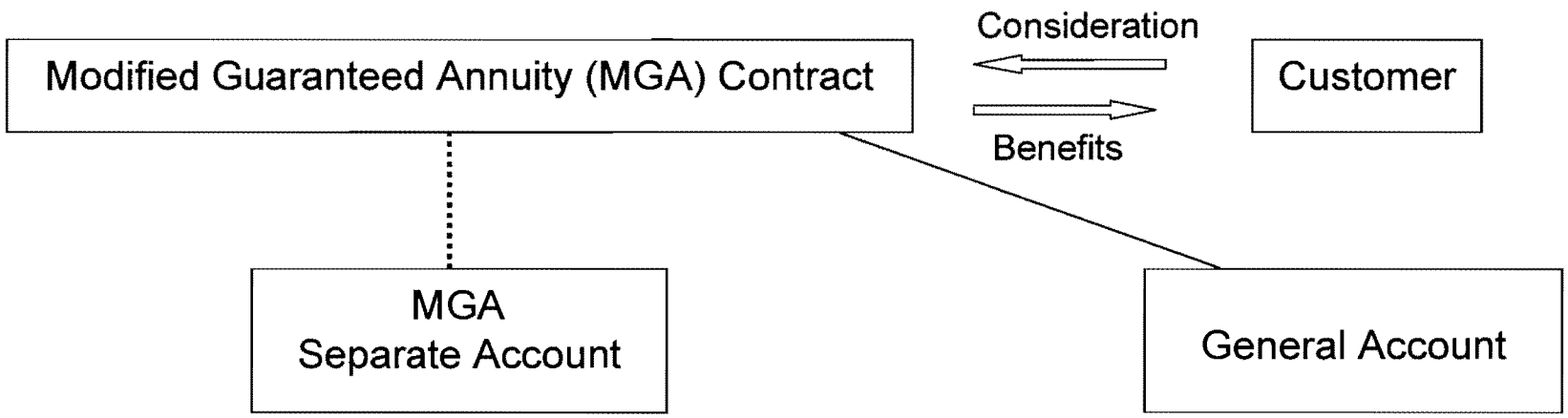
Life Insurance Company Variable Separate Account Structure



- Customer can be institutional or retail.
- Separate account assets support only specific policies/contracts and are insulated from other insurance company liabilities. They are invested in accordance with investment options offered by the insurance company and selected by the customer.
- Investment performance of separate account assets is passed through to the customer.
- Policy/contract will provide one or more insurance benefits (e.g. death benefits; guaranteed crediting rate; guaranteed lifetime payments). These benefits are paid for by the customer through additional charges and are obligations supported by the insurer's general account and the separate account.
- General account liabilities in respect of guaranteed benefits are generally reserved against by the general account.

Note: these illustrations are generic and subject to state laws, which vary.

Life Insurance Company Hybrid Separate Account Example



- Customers are generally retail.
- Separate account assets support only specific contracts and are insulated from other insurance company liabilities.
- Investment performance of MGA separate account assets is not passed through to the customer (hence dotted line).
- Insurance company provides insurance benefits (e.g. guaranteed crediting rate; guaranteed annuity payments). These benefits are not paid for by the customer through additional charges but are funded by general and separate account spread income.
- Separate account assets must be invested in accordance with general account investment laws.

Note: these illustrations are generic and subject to state laws, which vary.

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

January 24, 2012

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

The Honorable John G. Walsh
Acting Comptroller of the currency
Department of the Treasury
250 E St, SW
Mail Stop 2-3
Washington, DC 20219

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

The Honorable Mary L. Schapiro
Chairman
Securities & Exchange Commission
100 F St., NE
Washington, DC 20549-1090

Re: Notice of Proposed Rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (FRS Docket No. R-1432 & RIN 7100 AD 82; OCC Docket ID OCC-2011-14; FDIC RIN 3064-AD 85; SEC File Number S7-41-11).

Dear Sirs and Madam:

These comments are submitted on behalf of the American Council of Life Insurers (ACLI). The ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. We appreciate the opportunity to submit comments on the agencies' joint proposed rulemaking on prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedge funds and private equity funds. For purposes of this letter, we refer to the Section 619 of the Dodd-Frank Act (adding Bank Holding Company ("BHC") Act § 13) as the "Volcker Rule," the federal regulatory agencies that proposed the rulemaking as the "Agencies" and the proposed rules attached to the proposed rulemaking as the "Proposed Regulations.

I. Introduction

The Volcker Rule is one of the most important and complex provisions in the Dodd-Frank Act. As the Agencies have recognized in the preamble to the Proposed Regulations, implementation of the Volcker Rule through the mandated rulemaking process involves an intricate analysis of the statutory provisions, including subtle but important distinctions among activities. Recognition of these subtle distinctions is necessary, for example, to permit banking entities "to continue to provide client-oriented financial services."[1] As the Agencies have further recognized in the preamble, the Proposed Regulations must also take appropriate recognition of the interests of a banking entity in preserving its ability "to continue to structure its businesses and manage its risks in a safe and sound manner."

We also appreciate the efforts of the Agencies reflected in the Proposed Regulations to identify areas that require greater clarity as well as their efforts to provide appropriate latitude to banking entities to continue to provide client-oriented services. Recognition of the need and desirability of providing client-oriented services is crucial not only to the banking entities, but even more importantly to their clients and the overall markets themselves. The efficient functioning of the markets, including for the institutional investor community, requires that banking entities be permitted to provide market making and other client-driven services. One area of significant concern which has been identified by the larger financial community is the impact the Volcker Rule will have on overall liquidity in the marketplace, particularly in the secondary markets. While our commentary in this letter does not focus on that issue, the ACLI will be filing a separate letter on that specific subject since, as important long-term investors in the financial markets, we share that concern. We urge you to give serious consideration to that commentary, as well as the comments you receive on the issue from other institutional investor groups.

Our comments in this letter are more narrowly focused and relate specifically to the provisions of the Proposed Regulations as they affect insurance companies that are affiliated with insured depository institutions. As a threshold matter, it is important to observe that in enacting the Volcker Rule, Congress expressly recognized the need to "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws."[2] The specific reference to insurance company *investment* laws makes it clear that the accommodation required under the Volcker Rule relates both to the proprietary trading restrictions and the private equity and hedge fund investment restrictions.

The basis for this accommodation flows from the fact that insurance companies are subject to comprehensive state investment laws that are specifically designed to promote the safety and soundness of the regulated insurance company through such measures as investment limits and diversification requirements. The basis for this accommodation also flows from the fact that the insurance company model is different from virtually all other financial institution models in its predominant focus on long-term liabilities and on the supporting these long-term liabilities with long-term assets and investments. Because of the unique nature of insurance company operations, recognition and preservation of state investment law authority is essential to the safe and sound conduct of the insurance business. This applies as much to state investment law authority to invest in private equity or hedge funds as it does to the state investment law authority to engage in putative proprietary trading. Furthermore, an essential part of the business of insurance is that both the insurer general account and separate accounts invest in a broad range of investments, including private equity and hedge funds, as permitted under applicable insurance law.

Recognition of these fundamental points is essential to any exercise in accommodating the business of insurance in the context of the Volcker Rule. We believe that several changes and clarifications to the Proposed Regulations are necessary both to conform the Proposed Regulations to the statutory intent of the Volcker Rule and to appropriately accommodate the business of insurance.

---

1 Proposed Regulations, Supplementary Information, pt. II.A.

2 12 U.S.C. § 1851(b)(1)(F).

II. Executive Summary

We believe that the Volcker Rule provisions were not intended to prohibit insurance company general account or separate account investment activity or any combination of general account and separate account investment activity, including as to guaranteed separate accounts and other hybrid accounts,[3] conducted in compliance with applicable insurance law with respect to either proprietary trading activities or private equity or hedge fund investment activities. The Proposed Regulations, however, create two gaps, which appear to have the effect of subjecting permitted insurance company investment activities to the prohibitions contained in the Proposed Regulations.

First, the Proposed Regulations exclude insurance company general account and separate account activity from the proprietary trading restrictions in Subpart B. However, the Proposed Regulations do not expressly refer to general account or separate account activity in Subpart C, thereby creating the implication that general account and separate account activities conducted in accordance with state insurance investment law are subject to the investment restrictions contained in Subpart C. Such a result would be inconsistent with the Volcker Rule statute itself. To conform the Proposed Regulation to the language and intent of the statute, we request that the following insurance company investment activities be specifically recognized as "permitted activities" in the Proposed Regulations:

1. General account and separate account investing in any investment allowed under applicable insurance law, including a covered fund.

2. An insurance company establishing any separate account in compliance with applicable insurance law.

3. An insurance company establishing a subsidiary under applicable insurance law that makes investments.

Second, the drafting of the definitions of "general account" and "separate account" would create a gap with the result that certain insurance company investment activity is captured by neither the "general account" exemption nor the "separate account" exemption. In order to eliminate this possible gap, we request that the definition of "separate account" be aligned with the separate account exemption conditions by adding the § __.6(b)(2)(iii)(C) condition to the "separate account" definition in § __2(z).

Lastly, we believe that the reporting and recordkeeping requirements and compliance monitoring included in the set forth in §§ __.7, __.15 and __.20 and Subpart D should not apply to insurance company investment activities that are permitted activities under BHC Act § 13 and the Proposed Regulations. A detailed discussion of each of these comments is set forth in Parts IV through VIII below.

III. Insurance Regulation and Accommodating the Business of Insurance

A. Insurance Regulation

---

[3] The instructions to Federal Reserve Board Form FR Y-9C, Schedule HC-F (June 2011), Line Item 5c), refer to "hybrid account life insurer assets" and describes a "hybrid account insurance policy" as follows: "A hybrid account insurance policy combines features of both general and separate account insurance products. Similar to a general account life insurance policy, a hybrid policy offers a guaranteed minimum crediting rate, does not carry market value risk, and does not require stable value protection. However, like a separate account life insurance policy, a hybrid policy's cash surrender value is supported by assets segregated from the general assets of the insurance carrier." See www.federalreserve.gov/reportforms/forms/FR_Y-9C20111231_i.pdf, at p. HC-F-3.

The Financial Stability Oversight Council, in its study on the Volcker Rule,[4] recognized the unique nature of insurance company investment activity and its regulation in such observations as the following:

- "Insurance companies assume risk and collect premiums and, in turn, invest those premiums. Investment returns contribute to the company's net worth (i.e., policyholder surplus), which in turn supports underwriting and the payment of future claims to policyholders and claimants."

- "The investment activity of [insurance] companies is central to the overall insurance business model and could be unduly disrupted if certain provisions of the Volcker Rule applied."

- "Insurance company investment is subject to relevant state investment laws which, while not uniform, are substantially similar and generally conform to standards set out in model laws and regulations developed by the National Association of Insurance Commissioners ("NAIC"). State investment laws aim at limiting the amount and type of investments insurers can make in order to limit their investment and counterparty risk exposure. For example, among other limitations, investment laws limit the amount of investment an insurer can make in equities, low-grade securities, or in the securities of any one issuer."

- "State insurance company investment laws and regulations govern the type of investment, and extent of such investments, an insurance company can include as "admitted" assets on their balance sheet for the purpose of determining whether the insurance company has the ability to discharge its obligations and meet capital and surplus requirements. Insurance companies can make otherwise prohibited investments, but such investments are not considered admitted assets and still have to be reported to state insurance regulators."

- "State agencies monitor insurer investments, through reporting, valuation, and examination, to ensure that such investments are in compliance with state insurance investment laws, regulations, and guidance, and, even when insurers are otherwise in compliance to ensure that such investments do not threaten the solvency of the insurer."

As recognized in the Financial Stability Oversight Council study on the Volcker Rule, state insurance investment laws are designed to promote safety and soundness of the insurance company – they directly impact prudent product design and help reduce the risk presented by the unique nature of insurance operations, such as the long-term maturity profile of insurance liabilities.

In addition, State insurance laws and regulations address many other aspects of the business of insurance, including, importantly, financial matters such as standards of solvency, statutory reserves, reinsurance and capital adequacy. Each insurance company is required to file reports, generally including detailed annual financial statements, with State insurance regulators in each of the jurisdictions in which it does business, and its operations and accounts are subject to periodic examination by such authorities. Each insurance company is subject to risk-based capital requirements, and reports its risk-based capital based on a formula calculated by applying factors to various asset, premium and statutory reserve items, as well as taking into account the risk characteristics of the insurance company. The formula is used as an early warning regulatory tool to identify possible inadequately capitalized insurance companies for purposes of initiating regulatory action. Insurance laws provide State insurance regulators the authority to require various actions by, or take various actions against, insurance companies whose risk-based capital ratio does not meet or exceed certain levels.

---

[4] Financial Stability Oversight Council, *Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds*, p. 71-73 (Jan. 2011).

B. Accommodating the Business of Insurance

The fact that insurance regulation generally, and insurance investment regulation specifically, is so comprehensive is the basis for the principle that the Volcker Rule must "appropriately accommodate the business of insurance within an insurance company." That principle extends to all insurance company investment activity and is applicable both to the proprietary trading restriction and to the covered fund restriction. Prohibiting an insurance company from engaging in any investment activity that is allowed under applicable insurance law would be inconsistent with the principle of accommodating the business of insurance. Therefore, the Proposed Regulations should be revised and clarified to accommodate the three insurance investment activities described in Part II above.

IV. Subpart C – Insurance Company Investing in Covered Funds

A. Requested Change

We appreciate that, in connection with the proprietary trading prohibition, the Proposed Regulations (a) incorporate the "regulated insurance company" permitted activity in § __.6(c) and (b) confirm that the "on behalf of customers" permitted activity includes the purchase or sale of a covered financial position for an insurance company separate account in § __.6(b)(2)(iii). These provisions address an insurance company's investment activity that supports fixed contracts that are backed solely by general account investments, variable contracts that are backed solely by separate account assets and guaranteed separate account contracts and other hybrid accounts that are backed by both general and separate account assets. In addition, we appreciate the clarification in the Proposed Regulations that these two insurance company permitted activities extend to the investment activity of all insurers, both U.S. and foreign, affiliated with a banking entity. However, the Volcker Rule itself extends the "regulated insurance company" and separate account "on behalf of customers" permitted activities to the prohibition against investing in private equity or hedge funds and accordingly we request that Subpart C be amended to expressly include these two exemptions.

B. Analysis and Discussion

The statutory directive of BHC Act § 13 is to have the Volcker Rule "appropriately accommodate the business of insurance within an insurance company" by allowing insurance companies to continue to engage in general and separate account investing subject to regulation in accordance with relevant insurance company investment laws. Furthermore, the language of BHC Act § 13 itself exempts insurance company general account and separate account investments from the restriction on investing in private equity or hedge funds. Lastly, imposing the covered fund prohibition on insurance company investment activity would conflict with the specific provisions of state insurance investment laws that are designed to promote both appropriate diversification of investments and the appropriate use of long-term assets to fund long-term liabilities of insurance companies. State investment laws are at bottom designed to promote the safety and soundness of insurance operations. Pre-empting the operation of these state investment laws would not promote the goal of safety and soundness but would actually undermine it.

Accommodating the Business of Insurance. As stated above, the principle that the Volcker Rule must "appropriately accommodate the business of insurance within an insurance company" is as applicable to the covered fund restriction as it is to the proprietary trading restriction. BHC Act § 13(d)(1)(D) and (F) permit an insurance company to invest in covered funds to the extent allowed by applicable insurance investment law. Prohibiting an insurance company from investing in a covered fund (under the covered fund prohibition) to the extent allowed under applicable insurance law would be inconsistent with the principle of accommodating the business of insurance – what the proprietary trading exemption would allow within the constraints of applicable insurance law, the covered fund prohibition would take away. Recognizing the state investment law authority to invest in private equity or hedge funds is as necessary

to accommodate the business of insurance as recognizing the investment law authority to permit proprietary trading.

Volcker Rule Statutory Language. The covered fund prohibition as set forth in BHC Act § 13(a) provides as follows:

> (a) IN GENERAL.— (1) PROHIBITION.—Unless otherwise provided in this section, a banking entity shall not – . . . (B) *acquire* or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund. (*emphasis added*)

The list of permitted activities in BHC Act § 13(d)(1) begins with the following wording:

> *Notwithstanding the restrictions under subsection (a),* to the extent permitted by any other provision of Federal or State law, and subject to the limitations under paragraph (2) and any restrictions or limitations that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, may determine, the following activities (in this section referred to as 'permitted activities') are permitted: (*emphasis added*)

The "on behalf of customers" and "regulated insurance company" permitted activities in BHC Act § 13(d)(1)(D) and (F) each read, in relevant part, as follows:

> (D) The purchase, sale, *acquisition*, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers.
>
> * * * * *
>
> (F) The purchase, sale, *acquisition*, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company, if – . . . (*emphasis added*)

On the face of the language of BHC Act § 13(a), the permitted activities in subparagraphs (D) and (F) are exemptions both to the proprietary trading prohibition and the covered fund prohibition. BHC Act § 13(a)(1)(B) provides that a banking entity may not "acquire" any equity, partnership or other ownership interest in a hedge fund or private equity fund. The Proposed Regulations also uses the same activity word, "acquire," in its statement of the covered fund prohibition in § __.10(a). Subparagraphs (D) and (F) of BHC Act § 13(d)(1), the "on behalf of customers" and "regulated insurance company" permitted activities, also use the same activity wording – they permit the "acquisition" of "securities and other instruments" notwithstanding proprietary trading prohibition and the covered fund prohibition. Since the permitted activity ("acquisition") matches the prohibited activity ("acquire"), the plain meaning of the statute is that these permitted activities provide an exemption from the covered fund prohibited activity as well as the proprietary trading prohibition.

There is also a clear alignment between the instruments in BHC Act § 13(a)(1)(B) that may not be acquired by a banking entity under the covered fund prohibition ("any equity, partnership or other ownership interest in . . . a hedge fund or a private equity fund") and the kinds of instruments that may be acquired under the subparagraph (D) and (F) permitted activities ("securities and other instruments described in subsection (h)(4))"). The securities and other instruments described in subsection (h)(4)

are "*any* security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may . . . determine." Since the securities and other instruments described in subsection (h)(4) include *any* security, a security representing an investment or ownership interest in a private equity and hedge fund is clearly among the securities and other instruments that may be acquired under the subparagraph (D) and (F) permitted activities.[5]

We request that the permitted covered fund activities and investments under Subpart C of the Proposed Regulations be expanded to include explicitly an insurance company separate account "on behalf of customer" exemption and a "regulated insurance company" exemption subject to the same conditions as the comparable exemptions in Subpart B of the Proposed Regulations, §§ __.6(b)(2)(iii) (insurance company separate accounts) and 6(c) (regulated insurance company). In each case, the permitted covered fund activity will be limited to compliance with applicable insurance company investment laws. We propose the amending wording attached as Appendix A be added as a new § __.13(e) to the Proposed Regulations. Furthermore, as a technical amendment, the definitions of "foreign insurance regulator," "general account" and "State insurance regulator" should be moved from Proposed Regulations § __.3(c) (Subpart B, proprietary trading definitions) to Proposed Regulations __.2 (general definitions) so that they will apply equally to Subpart B and Subpart C (where the new insurance company permitted covered fund activities will be added).

Conflict with State Investment Law Regime and the Goal of Safety and Soundness. State insurance laws establish a detailed and comprehensive investment regime for insurance companies. These laws are specifically designed to promote the safe and sound operation of insurance companies *inter alia* by establishing limits and diversification requirements and by fostering investments in longer-term instruments that more appropriately correspond to the long-term liability structure of insurance companies. Covered funds and other alternative investments provide insurance companies access to companies, markets and investment strategies to create diversification benefits which otherwise would be inefficient or more difficult for insurance companies to try to recreate on their own. In addition, alternative investments have low historical correlation to other insurance company investments and afford a key portfolio construction tool to fund long-dated liability products and insurance company surplus accounts. Alternative investments also provide insurance companies with access to other world-class asset managers with strong governance protections and alignment of interests. Lastly, alternative investments have generated historically high rates of return and have outperformed public equity indices over a 10+ year period with lower volatility.

Denying insurance companies access to alternative investments would not further the underlying purpose of the Volcker Rule. Rather it would have harmful effects both on the insurance company and its customers. Insurance companies have existing long-term insurance liabilities and must appropriately plan to meet those liabilities using an investment strategy that includes permitted investments. Insurance companies widely use investment strategies that include reliance on a wide variety of asset classes that include alternative investments that are available in the form of covered funds. If the

---

[5] We recognize that subsection (d)(1)(F) refers to the purchase or sale of "securities and other instruments described in subsection (h)(4)," and that subsection (h)(4) defines proprietary trading. However, this does not indicate that the subsection (d)(1)(F) exemption is limited to proprietary trading. Subsection (d)(1)(F) refers to "securities and other instruments" *described* in subsection (h)(4); subsection (d)(1)(F) does not refer to "proprietary trading" described in subsection (h)(4). The instruments *described* in subsection (h)(4) include "any security." Because the plain language of subsection (d)(1)(F) clearly provides that the purchase or sale of any security or instrument *described* in subsection (h)(4) is permitted, there is no basis for creating an implication that the exemption in subsection (d)(1)(F) is intended to apply only to proprietary trading activities. To conclude otherwise would conflict with established canons of statutory construction, which provide that, if the meaning of a particular phrase is clear, no other section or part of a statute should be applied to create a doubt as to its meaning. See 2A Norman J. Singer and J.D. Shambie Singer, SUTHERLAND ON STATUTORY CONSTRUCTION, § 47.2, at 279 (7th ed. 2007).

Volcker Rule as applied to insurance companies bars covered fund investments, these investments will have to be eliminated resulting in a weakened ability to manage assets and liabilities due to the lack of appropriate substitutes for federally prohibited covered funds.

In addition to their importance to insurance company claims paying ability, alternative investments through covered funds are also vital to insurance company profitability and ability to pay dividends and offer crediting rates on insurance products such as whole life insurance sold to individuals and stable value investment options offered to participants in defined contribution retirement plans. A covered fund prohibition will likely reduce credited interest rates on both existing and future insurance products with adjustable crediting rates and dividend rates on participating policies as each are tied to earnings on insurance company assets.

Finally, we note that there is no evidence to suggest that Congress had any concerns about insurance company general account or separate account investments in hedge funds or private equity funds (much less the much broader universe of "covered funds" as defined in the Proposed Rules), or sought to create new federal insurance company investment laws through the Volcker Rule.

V. Subpart C – Insurance Company Sponsoring Unregistered Separate Accounts

A. Requested Confirmation

We note that the Proposed Regulations provide an exemption to permit a banking entity to acquire an ownership interest in or sponsor a separate account used solely to purchase a bank owned life insurance policy. We support this provision. We request that the Agencies also confirm that an insurance company (that is a banking entity for purposes of the Volcker Rule) may continue to provide the traditional range of insurance products supported by unregistered separate accounts to its clients as part of its ordinary insurance business.

B. Analysis and Discussion

The SEC and the courts take the view that, in order to effect the disclosure and other investor protection purposes of the Investment Company Act of 1940 (the "Investment Company Act") with respect to variable insurance and annuity products offered to the retail public, an insurance company separate account is itself an "investment company" within the meaning of the Investment Company Act. Such separate accounts are not required to be registered and regulated under the Investment Company Act if the relevant insurance contracts are issued in a private placement and either (i) contract owners are limited to "qualified purchasers" (in which case the separate account may rely on section 3(c)(7)), or (ii) there are no more than 100 contract owners (in which case the separate account may rely on section 3(c)(1)).[6] In these circumstances, an unregistered separate account might itself be deemed to be a "hedge fund" or "private equity fund" within the meaning of BHC Act § 13(h)(2) (and a "covered fund" as defined in Proposed Regulations § __.10(b)(1)). If so, the question then arises whether the insurance company could be deemed to be "sponsoring" the separate account within the meaning of BHC Act § 13(h)(5).

An insurance company should not be deemed to be "sponsoring" a separate account within the special meaning of that term as defined in BHC Act § 13(h)(5). The definition of the term "sponsor" contained in BHC Act § 13(h)(5) presupposes that the fund is separate legal entity from the sponsor, but as a separate legal entity it is nonetheless managed or controlled by the sponsor or associated with the sponsor by sharing the name of the sponsor. But a separate account is merely a designated pool of assets on the insurance companies' own balance sheet and is not a separate legal entity so an insurance company cannot serve as a general partner, managing member, or trustee of a separate

---

[6] Where the only insurance contract holders are qualified pension plans, the separate accounts, like similar bank collective investment funds, are exempt under section 3(c)(11) of the Investment Company Act.

account. Similarly, since the separate account is not a separate legal entity, the insurance company cannot select or control a majority of the directors, trustees, or management of a separate account. Likewise, it is unclear how an insurance company can be said to "share" a name with itself.

Since the separate account represents a specified pool of assets of the insurance company that support a policy claim on the insurance company, and is not a separate legal entity or fund within the intended meaning of BHC Act § 13(h)(2), the insurance company cannot be a "sponsor" of its separate accounts within the special meaning of BHC Act § 13(h)(5). Any other reading of the definition would cause the result, clearly not intended by Congress, that significant parts of the ordinary business of insurance companies would be prohibited.

Accordingly, we request that the Agencies confirm that separate accounts maintained in accordance with applicable insurance laws are not subject to the covered fund prohibitions in the Proposed Regulations. To do otherwise would bar insurance companies from establishing unregistered separate accounts which are currently used, for example, to allow a corporation to purchase corporate owned life insurance on the lives of its employees, an individual to purchase private placement variable life insurance on his or her life, and a corporation to purchase a group variable annuity contract that supports its pension and retirement plan obligations.[7]

VI. Subpart C – Insurance Company Establishing a Permitted Subsidiary

A. Requested Change

Many state insurance laws authorize an insurance company to invest in or organize subsidiaries for the purpose of making investments under applicable insurance law. Such a subsidiary may technically fall within the definition of "covered fund" if it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act. If so, an insurance company that is a banking entity would be prohibited from investing in or organizing the subsidiary as a "covered fund." We request that an exemption to the covered fund prohibition be added to the Proposed Regulations to allow an insurance company to invest in or organize a subsidiary for the purpose of making investments under applicable insurance law.

B. Analysis and Discussion

Accommodating the business of insurance must include accommodating the authority in applicable insurance law to invest in or organize subsidiaries for the purpose of making investments.

Subpart C, § __.14(a)(2), provides that the covered fund prohibition does not apply to owning an interest in or sponsoring certain entities that would otherwise qualify as a covered fund. We request that an insurance company permitted subsidiary be added to this list to allow an insurance company to invest in or organize a subsidiary as permitted under applicable insurance law. While insurance company subsidiaries are not required as a matter of applicable insurance law to be wholly-owned, we are sensitive to any concern that might be raised by the possibility of interests being owned in such a subsidiary by unaffiliated third parties. Therefore, we propose that the exemption be available only for a subsidiary that is wholly-owned by the insurance company itself or by the insurance company and entities that are affiliated with the insurance company. We propose that the following be added as a new Proposed Regulations § __.14(a)(2)(vi):

---

[7] In the Proposed Rules, the Agencies appropriately exempted bank-owned life insurance from the covered fund prohibitions, with respect to both purchase by insured depository institutions and their affiliates and issuance by insurance companies that are banking entities. We believe that there is an equally valid basis to exempt generally insurance company products supported by unregistered insurance company separate accounts, and we would be glad to provide further comments if the Agencies desire. However, in light of the clear language in BHC Act § 13(h)(5), under which it is not reasonable to consider that insurance companies "sponsor" their separate accounts, we believe the Agencies do not need to reach the question of exemption.

(vi) A wholly-owned subsidiary of a covered banking entity in which one or more affiliated insurance companies invests in compliance with, and subject to, the insurance company investment and other laws, regulations, and written guidance of the State or jurisdiction in which each such insurance company is domiciled.

VII. Bridging Any Potential Gap Between the "General Account" and "Separate Account" Exemptions

A. Requested Change

As stated above, in order to effectively accommodate the business insurance, insurance company investment activity permitted under applicable insurance law should be exempted from both the proprietary trading prohibition and the covered fund prohibition of the Volcker Rule. As a consequence, all permitted insurance company investment activity should be subject to either the "general account" exemption under § __6(c) or the "separate account" exemption under § __6(b)(2)(iii). While that is the apparent intent of the Proposed Regulations, some insurance company separate account investment activity might inadvertently fail to satisfy either exemption since the investment may at the same time be allocated to a separate account as defined in § __.2(z) (and thus not be an investment for the "general account" as defined in § __3(c)(6)), but also some of the profits and losses arising from the investment may inure to the benefit or detriment of the insurance company (and thus fail condition § __.6(b)(2)(iii)(C) to the separate account exemption).

This inadvertent problem can be remedied by adding the § __.6(b)(2)(iii)(C) condition to the § __.2(z) definition of "separate account." This change will eliminate any potential gap created by the lack of symmetry between the separate account exemption conditions (especially condition § __.6(b)(2)(iii)(C)) and the definition of "separate account" which is not subject to the § __.6(b)(2)(iii)(C) condition. The change will assure that all insurance company investment activity permitted under applicable insurance law qualifies for the appropriate exemption – either the general account exemption under § __6(c) or the separate account exemption under § __6(b)(2)(iii) (together with the comparable exemptions requested in Part IV above in respect of covered funds).[8]

B. Analysis and Discussion

Subpart B, § __.6(b)(2)(iii), of the Proposed Regulations provides four conditions that must be met for a covered banking entity that is an insurance company to purchase or sell a covered financial position for a separate account and that purchase and sale to be considered on behalf of customers and exempted from the prohibition on proprietary trading contained in § __.3(a). The third condition requires that:

> (C) All profits and losses arising from the purchase or sale of a covered financial position are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policies supported by the separate account, *and not the insurance company*; (*emphasis added*)

While this condition is true for insurance company variable separate accounts, applicable insurance law also allows an insurance company to allocate or transfer its own funds to a separate account with the profits or losses on those funds inuring to the benefit or detriment of the insurance company. Two examples of this permitted separate investment activity are "seed money" and separate accounts that are used to support certain non-variable separate account contracts.

---

[8] In the alternative, the potential gap could also be eliminated by conforming the separate account definition and separate account exemption through deleting condition § __.6(b)(2)(iii)(C) to the separate account exemption. This alternative approach would better align the kinds of separate accounts eligible for the separate account exemption with the kinds of separate accounts that are authorized and recognized under applicable insurance law.

Seed Money. New York Insurance Law Section 4240(a)(3) permits a life insurance company to "allocate amounts to a separate account to facilitate its initial operations" – so-called "seed money."[9] Seed money is typically reimbursed to the insurance company within a reasonable period of time after it is allocated to the separate account.[10] New York Insurance Law Section 4240(a)(3) also requires that such seed money be subject to certain general account qualitative standards and quantitative limitations.

Certain Non-Variable Separate Account Contracts. Separate account assets may support modified guaranteed contracts,[11] market value adjusted contracts and contracts with book value guarantees similar to contracts generally in the general account.[12] Because the insurance company is responsible for credit related asset loss or fair value loss in connection with these kinds of contracts, statutory accounting practices require that the insurance company establish an asset valuation reserve for the separate account assets supporting these contracts.[13] Because of the risk assumed by the insurance company, the model regulation of the National Association of Insurance Commissioners governing modified guaranteed annuities requires that the separate accounts relating to modified guaranteed annuities be subject to the insurance company's general account investment laws (unless otherwise approved by the state insurance regulator).[14]

Insurance company investment activity in respect of separate account "seed money" and separate accounts that are used to support these kinds of non-variable separate account contracts may inadvertently fail to satisfy either the general account exemption under § __6(c) as currently drafted or the separate account exemption under § __6(b)(2)(iii) as currently drafted since the investment may be allocated to a separate account as defined in § __.2(z) (and thus not an investment for the "general account" as defined in § __3(c)(6)) and some of the profits and losses arising from such investment may inure to the benefit or detriment of the insurance company (and thus fail condition § __.6(b)(2)(iii)(C) to the separate account exemption). In order to eliminate this potential gap between these two exemptions, we request that the definition of "separate account" be aligned with the separate account exemption conditions by adding the § __.6(b)(2)(iii)(C) condition to the "separate account" definition. We

---

9 *See also* Connecticut Insurance Code Section 38-433(a)(6): New Jersey Insurance Code Section 17B:28-9(c).

10 The New York Department of Financial Services generally requires that seed money be repaid within two years. *See* "Separate Account Agreements" Product Outline, pt. II.E(3)(a)(iii), available at www.dfs.ny.gov/insurance/acrobat/saaout.pdf. In New York, the seed money duration is set out in the insurance company's separate account plan of operation which, in New York, is approved by the New York Superintendent of Financial Services. *See* New York Insurance Law Section 4240(e).

11 A "modified guaranteed annuity" is defined to mean "a deferred annuity contract, the underlying assets of which are held in a separate account, and the values of which are guaranteed if held for specified periods. The contract contains nonforfeiture values that are based upon a market-value adjustment formula if held for shorter periods. This formula may or may not reflect the value of assets held in the separate account. The assets underlying the contract shall be in a separate account during the period or periods when the contract holder can surrender the contract." National Association of Insurance Commissioners, Modified Guaranteed Annuity Model Regulation, Model 255, § 4.A.

12 In connection with group life and group annuity contracts and funding agreements, a "book value contract" is defined to mean "a fixed accumulation contract (GIC), purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, that does not participate in the investment experience of a separate account, with a fixed interest rate guarantee, including a guarantee based on an external index, and that is supported by a separate account, the plan of operations of which provides that the separate account's assets are valued as if the assets were held in the insurance company's general account." National Association of Insurance Commissioners, Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts Model Regulation, Model 200, § 4.H.

13 National Association of Insurance Commissioners, Accounting Practices & Procedures Manual as of March 2011, Statement of Statutory Accounting Principles No. 56, ¶ 20.

14 National Association of Insurance Commissioners, Modified Guaranteed Annuity Model Regulation, Model 255, § 9.D.

propose the following amending wording to the § __2.(z) definition of "separate account" (underlined text is added):

> (z) Separate account means an account established and maintained by an insurance company subject to regulation by a State insurance regulator or a foreign insurance regulator under which:
>
> (1) income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company; and
>
> (2) all profits and losses arising from the purchase or sale of a covered financial position or the acquisition or retention of any ownership interest in a covered fund are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policies supported by the separate account, and not the insurance company.

By making this change, the intent of the Proposed Regulations in respect of the separate account exemption will be preserved in that variable separate accounts with "legally segregated" assets (for which there is no insurance company "seed money") will remain eligible for the separate account "on behalf of customers" exemption. However, the following kinds of separate accounts would qualify for and be subject to the general account exemption:

- Variable separate accounts with "seed money," whether or not the assets in the account are "legally segregated" (these would not be a separate account under the revised definition since profits and losses may inure to the benefit of the insurance company; therefore, the assets in these accounts will be "general account" assets and would qualify for the general account exemption)

- Non-variable separate accounts, whether or not the assets in the account are "legally segregated" (these would also not be a separate account under the revised definition since profits and losses may inure to the benefit of the insurance company; therefore, the assets in these accounts will be "general account" assets and would qualify for the general account exemption)

- Separate accounts the assets of which are not "legally segregated" (by not being "legally segregated," these assets satisfy the definition of "general account" and would qualify for the general account exemption)

This allocation of separate account investments to the general account and separate account exemptions is especially appropriate since, as stated above, separate account "seed money" and investments for separate accounts relating to modified guaranteed annuities are typically subject to the insurance company's general account investment laws.[15]

VIII. Reporting and Recordkeeping Requirements and Compliance Monitoring

A. Requested Change

---

15 Furthermore, as a technical amendment, the definitions of "covered financial position" and "covered fund" may need to moved to Proposed Regulations § __.2 (general definitions) so that they will apply to this revised general definition of "separate account."

We believe that the reporting and recordkeeping requirements and compliance monitoring included in the set forth in §§ __.7, __.15 and __.20 and Subpart D should not apply to insurance company investment activities that are permitted activities under BHC Act § 13 and the Proposed Regulations since insurance companies already have, and have long had, comprehensive and effective oversight of their permitted investment activities under applicable insurance law.

B. Analysis and Discussion

As stated above, insurance companies are subject to comprehensive regulation of the kinds and amounts of investments they can make under the insurance laws and regulations of their domestic jurisdictions. These laws and regulations typically impose qualitative and quantitative limitations on general account investments by insurance companies. Separate account investments may also be subject to investment standards – certain prohibited investments or investment diversification requirements.

A typical insurance investment law requires that the insurance company's board of directors (or an investment committee of the board) adopt a written plan for acquiring and holding investments. The plan would include investment quality, maturity and diversification standards designed to assure that the investments are appropriate for the insurance company's business and its liquidity needs. The board of directors or investment committee typically has a oversight duty – it must receive and review a summary report on the insurer's investment portfolio and investment activities at least quarterly in order to determine whether the portfolio and activity is consistent with its written plan.

In addition, a domestic insurance regulator has the authority to and must, on a periodic basis, conduct an examination of the insurance company, including the authority to determine whether the investments made by the insurance company are in compliance with applicable insurance law and the written plan of the board or investment committee.

BHC Act § 13(d)(1)(F) expressly recognizes this comprehensive insurance investment regulatory scheme and gives appropriate deference to it, subject to the ability of Federal banking agencies, after consultation with the Financial Services Oversight Council and relevant State insurance regulators, to determine that a particular law, regulation or written guidance is insufficient to protect the safety and soundness of the insurance company, or the financial stability of the U.S.

The Proposed Regulations introduce reporting and recordkeeping requirements for both trading activities and (§ __.7) and covered fund activities and investments (§ __.15) together with a compliance monitoring requirement for both activities (§ __.20). While these requirements may be relevant to activities and investments of banking entities other than insurance companies because the Proposed Regulations may be the only substantive law or rule relating to these activities, we believe that that these are not relevant to and should not apply to insurance companies since insurance companies already have, and have long had, comprehensive and effective oversight of their permitted investment activity under applicable insurance law.

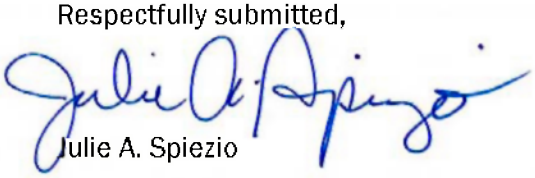
We request that the reporting and recordkeeping requirements and compliance monitoring set forth in §§ __.7, __.15 and __.20 and Subpart D should not apply to insurance company investment activity that are permitted activities under BHC Act § 13 and the Proposed Regulations. These would include (i) the permitted proprietary trading activities in §§ __.6(b)(2)(iii) (separate account) and 6(c) (regulated insurance company); and (ii) permitted covered fund activities and investments described in Part IV of this letter (insurance company investing in covered funds). Among the rules that should have such an insurance company exception are the following:

1. The general requirements in §§ __.7 (including the $1 billion threshold in § __.7(a)) and __.15 (including compliance with the reporting and recordkeeping requirements in Appendix A and its quantitative thresholds).

2. The program for monitoring compliance in § __.20 (including the recordkeeping requirements in Appendix C) and the additional standards thresholds ($1 billion and 10% of total assets).

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

Respectfully submitted,



Julie A. Spiezio

CC:

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

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

Elizabeth M. Murphy
Secretary
Securities & Exchange Commission
100 F St., NE
Washington, DC 20549

Appendix A
New § __.13(e)

(e) Permitted covered fund investments by a regulated insurance company.

(1) The prohibition contained in § __.10(a) does not apply to the acquisition or retention of any ownership interest in a covered fund by a covered banking entity that is an insurance company for a separate account if:

(i) The insurance company is directly engaged in the business of insurance and subject to regulation by a State insurance regulator or foreign insurance regulator;

(ii) The insurance company acquires or retains any ownership interest in a covered fund solely for a separate account established by the insurance company in connection with one or more insurance policies issued by that insurance company;

(iii) All profits and losses arising from the acquisition or retention of any ownership interest in a covered fund are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policies supported by the separate account, and not the insurance company; and

(iv) The acquisition or retention is conducted in compliance with, and subject to, the insurance company investment and other laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled.

(2) The prohibition contained in § __.10(a) does not apply to the acquisition or retention of any ownership interest in a covered fund by a covered banking entity that is an insurance company or any affiliate of an insurance company if:

(i) The insurance company is directly engaged in the business of insurance and subject to regulation by a State insurance regulator or foreign insurance regulator;

(ii) The insurance company or its affiliate acquires or retains any ownership interest in a covered fund solely for the general account of the insurance company;

(iii) The acquisition or retention is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(iv) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (e)(2)(iii) of this section is insufficient to protect the safety and soundness of the covered banking entity, or of the financial stability of the United States.