THE FINANCIAL SERVICES ROUNDTABLE
Financing America's Economy

February 3, 2012

Via Regulations.gov

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20551

Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20520

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Comment Letter on Volcker Rule Issues Relevant to Insurance Companies

Ladies and Gentlemen:

The Financial Services Roundtable (the "Roundtable")[1] welcomes the opportunity to provide the Department of the Treasury, the Board of Governors of the Federal Reserve System (the "Board"), the Commodity Futures Trading Commission (the "CFTC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency (the "OCC") and the Securities and Exchange Commission (the "SEC" and together collectively with the Board, CFTC, FDIC, and OCC, the "Agencies") with comments on the proposed rules[2] implementing Section 13 of the Bank Holding Company Act of 1956 (the "Volcker Rule").[3] In this letter, we offer

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1 The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

2 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 8,265 (Nov. 7, 2011) [hereinafter the "Proposed Rules"]. The CFTC has issued a separate set of proposed rules, which largely mirror the Proposed Rules in content.

3 12 U.S.C. § 1851.

comments on several aspects of the Proposed Rules relevant to insurance companies. First, we discuss implementation of the Volcker Rule, including the requirement that the Agencies appropriately accommodate the business of insurance and the need for the Agencies to recognize the special characteristics of insurance companies. Second, we comment on the exemptions in Subpart B of the Proposed Rules for investment activity conducted through (i) the general account of an insurance company (the "General Account Exemption")[4] and (ii) separate accounts of an insurance company (the "Separate Account Exemption").[5] Third, we request that the Agencies clarify that the General Account Exemption and Separate Account Exemption equally apply to investments by insurance companies in "covered funds"[6] under Subpart C of the Proposed Rules. Fourth, we offer comments on bank-owned life insurance ("BOLI") and other products supported by unregistered separate accounts. Fifth, we comment on the ability of insurance companies to establish permitted subsidiaries. Sixth, we comment on the General Account and Separate Account Exemptions as they apply to certain insurance company investment activities. Finally, we offer comments on the applicability of the reporting, recordkeeping and compliance program requirements of the Proposed Rules to the activities of insurance companies.[7]

I. Introduction

A. Appropriate Implementation of the Volcker Rule

The Volcker Rule is a complex provision that requires carefully calibrated implementation. As the Agencies recognize in the Preamble to the Proposed Rules, the Volcker Rule must be implemented in a way that permits banking entities "to continue to provide client-oriented financial services."[8] As the Agencies also recognize, it is crucial that the Proposed Rules preserve the ability of a banking entity "to continue to structure its business and manage its risks in a safe and sound manner."[9] These general observations apply with a special force to insurance companies that are deemed to be banking entities based on their affiliation with an insured depository institution ("IDI"). The legislative drafters of the Volcker Rule understood the special situation of insurance

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4 *See* Proposed Rules, Subpart B, Section __.6(c).

5 *See* Proposed Rules, Subpart B, Section __.6(b)(2)(iii).

6 *See* Proposed Rules, Subpart C, Section __.10(b)(1) (defining "covered fund").

7 Please see Appendix B for cross-referenced responses to specific questions posed by the Agencies in the preamble to the Proposed Rules.

8 Proposed Rules, 76 Fed. Reg. 68,849 (Nov. 7, 2011).

9 Id.

companies and made special provision in the Volcker Rule for insurance companies. The regulations implementing the Volcker Rule must likewise take full recognition of the special situation of insurance companies.

B. Accommodation of the Business of Insurance

It is the intent of the Volcker Rule that the Agencies, in implementing the Volcker Rule, should "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws."[10] This statutory intent reflects a recognition of the extensive regulatory system to which insurance companies are subject. This extensive regulatory system includes among its provisions investment laws that are specifically designed to meet multiple regulatory objectives, such as to diversify risk among investment categories, limit exposure to particular types of asset classes, and permit insurance companies to support their long-term liabilities with appropriate long-term assets. This statutory intent also reflects an understanding of the differences between the insurance company business model and the business model of other financial institutions. The liability structure of insurance companies differs from that of other financial firms in being longer-term and less susceptible to liquidity risks. At the same time, the longer-term liability structure of insurance companies means that they need as a business and regulatory matter to rely on longer-term assets to support their longer-term liabilities.

C. Recognition of the Special Characteristics of Insurance Companies

In implementing the Volcker Rule, the Agencies must take recognition of the special characteristics of insurance companies, in particular the extensive investment law regimes to which insurance companies are already subject. As noted above, these investment laws have been designed by state and foreign authorities with long-standing and in-depth insurance expertise to ensure the safe and sound operation of insurance companies. These investment laws both reflect and reinforce the longer-term asset and liability components of the insurance company business model. For example, state insurance company investment laws generally include (but are not limited to) specific limits on investments in equities, low-grade securities, or the securities of any one issuer. State insurance laws also limit the type and extent of investments that an insurance company may include as "admitted" assets on its balance sheet for purposes of determining whether it can discharge its obligations and meet capital and surplus requirements.

In addition, insurance company investment activities are subject to comprehensive regulation and oversight. For example, state insurance regulators have broad oversight and examination power over all insurance company investments to ensure the

[10] Section 13(b)(1)(F).

investments are in compliance with state insurance investment regulations and that they do not threaten the solvency of the insurance company. As part of this regulatory and oversight regime, insurance companies are required to file annual financial reports covering their investment and other activities, and are required to meet and report certain risk-based capital ratios. By impacting various parts of the insurance company's risk profile, including its statutory reserves, capital adequacy, and overall solvency, existing insurance law regimes serve as an effective mechanism for regulating insurance company investment activities.

II. Proprietary Trading

A. General Account Exemption

We appreciate that the General Account Exemption exempts an insurance company's general account investment activities from the Volcker Rule's prohibitions on proprietary trading. Specifically, the General Account Exemption incorporates the statutory exemption of Section 13(d)(1)(F) of the Volcker rule by exempting the purchase or sale of a "covered financial position"[11] by an insurance company or its affiliate if: (i) the insurance company is directly engaged in the business of insurance and is subject to regulation by a state or foreign insurance regulator; (ii) the purchase or sale is solely for the insurance company's general account and is in compliance with the laws, regulations and written guidance of the state or foreign jurisdiction in which the insurance company is domiciled; and (iii) the particular law, regulation or written guidance has not been determined by the appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council (the "FSOC") and the relevant insurance commissioners, to be insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States. In the Preamble to the Proposed Rules, the Agencies indicate that they have not proposed to make such a determination at this time.[12]

B. Separate Account Exemption

We also appreciate that the Separate Account Exemption confirms that the activities permitted "on behalf of customers" under Section 13(d)(1)(D) of the Volcker Rule include the purchase or sale of a covered financial position for a separate account of an insurance company. Under the Separate Account Exemption, the purchase or sale of a covered financial position by a banking entity that is an insurance company is exempted if: (i) the insurance company is directly engaged in the business of insurance and is subject to regulation by a state or foreign insurance regulator; (ii) the insurance company

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[11] *See* Proposed Rules, Subpart B, Section __.3(b)(3)(ii) (defining "covered financial position").

[12] *See* Proposed Rules, 76 Fed. Reg. at 68,880, n. 172 (Nov. 7, 2011).

purchases or sells the covered financial position 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 purchase or sale of the covered financial position are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policy, and not the insurance company; and (iv) the purchase or sale is conducted in compliance with, and subject to, the insurance company investment and other laws, regulations and written guidance of the state or foreign jurisdiction in which the insurance company is domiciled.

We note, however, that the Separate Account Exemption (§ __.6(b)(2)(iii)) as currently drafted in the Proposed Rules is not completely symmetric with the separate account definition (§ __.2(z)) in the Proposed Rules with the result that certain insurance company investment activities could fail to qualify for either the General Account or Separate Account Exemption. As we discuss in Section VI below, we request that the Agencies amend the Separate Account Exemption to ensure that there are no inadvertent gaps in the treatment of permissible insurance company investment activities.

III. Investments in Covered Funds

A. Application of General and Separate Account Exemptions

As indicated, we appreciate that the Proposed Rules include both the General Account and Separate Account Exemptions to the proprietary trading prohibition in Subpart B. We also appreciate that the General and Separate Account Exemptions apply to any insurance company that is subject to regulation by a state insurance regulator or foreign insurance regulator. The Proposed Rules, however, do not provide for the application of these exemptions to the covered funds investment prohibition in Subpart C. The statutory intent of the Volcker Rule is to accommodate the business of insurance within an insurance company, which applies with equal force to the proprietary trading provisions and to the covered funds provisions of the Proposed Rules. The business of insurance within an insurance company inherently includes investment activity in longer-term investments. Accordingly, the Agencies should amend Subpart C of the Proposed Rules to extend the General Account Exemption and Separate Account Exemptions to investments in covered funds by an insurance company. Please see Appendix A for our proposed amendment to Subpart C.

1. Statutory Intent

In enacting the Volcker Rule, Congress intended that the Agencies fulfill the statutory mandate to "accommodate the business of insurance" by allowing insurance companies to continue their general and separate account investment activity to the extent allowed by applicable insurance law. Congress did not intend to prohibit insurance companies from engaging in general account and separate account investment activity, or any combination of general account and separate account investment activity, including

investment activities related to guaranteed separate accounts and other hybrid accounts, that is conducted in compliance with applicable insurance law with respect to either proprietary trading or covered fund investment activities.[13] As discussed, insurance companies' investments in covered funds are already regulated by applicable insurance laws, which are designed to promote and protect the safety and soundness of the insurance company while allowing it to diversify its investment portfolio.

2. FSOC Study

The FSOC Study recognized that Section 13(d)(1)(F) was included in the Volcker Rule because "[t]he investment activity of insurers is central to the overall insurance business model and could be unduly disrupted if certain provisions of the Volcker Rule applied."[14] The FSOC thus recommended that the Agencies preserve the "investment activity of insurers" so as to prevent undue disruption to the insurance company business model. Confirming that the General Account and Separate Account Exemptions also extend to insurance company investments in covered funds would be fully consistent with this recommendation. In contrast, by not allowing an insurance company to invest in covered funds through its general account or separate accounts, which would clearly and unduly disrupt the insurance company business model, the Agencies would both contradict the recommendation of the FSOC Study and extend the Volcker Rule prohibitions beyond the plain meaning of the statute in contravention of Congress' intent to accommodate the business of insurance.[15] We note that the FSOC Study in discussing the general account exemption in Section 13(d)(1)(F) consistently refers to "investment activity" and does not draw any distinction between proprietary trading and investments in funds, suggesting that the FSOC itself reads Section 13(d)(1)(F) to apply to any investments by the general account.

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[13] As the Board itself recognizes, hybrid accounts combine features of both general and separate account insurance products. *See* Instructions, Board Form FR Y-9C, Schedule HC-F (June 2011), Line item 5c, *available at* www.federalreserve.gov/reportforms/FR_Y-9C20111231_i.pdf.

[14] FSOC, *Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds*, at 71 (Jan. 2011) (the "FSOC Study").

[15] *See* Letter from Carolyn McCarthy, *et. al*., Members of Congress, to Benjamin S. Bernanke, Mary L. Schapiro, Martin J. Gruenberg, and John G. Walsh (Jan. 27, 2012) (emphasizing that in enacting the Volcker Rule, "Congress did not intend to prohibit insurance companies from investing in covered funds for their general accounts . . ." and that "it is imperative that, as the Agencies move forward, they follow Congressional intent and permit insurance companies to continue investing in covered funds for their general accounts.").

3. Statutory Structure and Text

Both the structure and the text of the Volcker Rule indicate that insurance company general and separate account investment activities are exempt from the covered funds prohibition.

Section 13(a)(1) of the Volcker Rule contains the general prohibitions against both proprietary trading and investments in covered funds. It reads as follows:

"*Unless otherwise provided in this section*, a banking entity shall not –

(A) engage in proprietary trading; or

(B) acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or private equity fund." (Emphasis added.)

Section 13(d) of the Volcker Rule, which enumerates the exemptions from these general prohibitions, reads as follows:

"*Notwithstanding the restrictions under [Section 13(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 that [the Agencies] may determine, the following *activities (in this section referred to as 'permitted activities') are permitted . . .* " (Emphasis added.)

By referring to the "restrictions under [Section 13(a)]," which includes *both* the prohibition on proprietary trading and the prohibition on covered fund investments, it is clear that Section 13(a)'s exemptions for the enumerated permitted "activities" apply to both proprietary trading and covered fund investment activities. Nothing in Section 13(d)(1)(F), which permits investment activities conducted through the general account of the insurance company or its affiliate, or Section 13(d)(1)(D), which permits investment activities conducted through separate accounts of the insurance company, contradicts this conclusion.[16]

In addition, Section 13(a)(1)(B) of the Volcker Rule, which contains the general prohibition against covered fund investments, uses the word "acquire." Sections 13(d)(1)(D) and 13(d)(1)(F), which contain the relevant permitted activities exemptions, both use the same activity wording when they authorize the *acquisition* of securities "*described in subsection (h)(4).*" Because the securities "described in subsection (h)(4)" include *any* security, securities representing investments or ownership interests in private equity or hedge funds are clearly among the securities that a banking entity engaged in an activity permitted under Section 13(d)(1)(D) or Section 13(d)(1)(F) may acquire. Put

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[16] *See* 2A Norman J. Singer and J.D. Shambie Singer, SUTHERLAND ON STATUTORY CONSTRUCTION, § 47:1, at 274 (7th ed. 2007) ("The starting point in statutory construction is to read and examine the text of the act and draw inferences concerning the meaning from its composition and structure.").

differently, there is no basis in the statute or in the legislative history to conclude that securities described in Section 13(h)(4) do not include interests in covered funds, or that Section 13(d)(1)(D) or Section 13(d)(1)(F) does not allow insurance companies to acquire interests in covered funds subject to and in compliance with applicable insurance law.

The fact that Section 13(d)(1)(F) cross-references subsection (h)(4), which defines the term "proprietary trading" for purposes of the Volcker Rule, does not support the conclusion that Section 13(d)(1)(F)'s exemption for general account investment activity should be limited only to proprietary trading activities. Rather than referring to proprietary trading activities as defined in subsection (h)(4), Section 13(d)(1)(F) provides that the purchase, sale, acquisition or disposition of any security or other instrument *described* in subsection (h)(4) is permitted. Because the plain language of Section 13(d)(1)(F) provides that the purchase, sale, acquisition or disposition of any security or instrument described in subsection (h)(4) is permitted, there is no basis for creating an implication that the exemption in Section 13(d)(1)(F) is intended to apply only to proprietary trading activities. To read Section 13(d)(1)(F) to apply only to proprietary trading activities because it references securities or instruments described in subsection (h)(4) would be to assign a different meaning to Section 13(d)(1)(F) than is evident from the literal language of Section 13(d)(1)(F). This 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 doubt as to its meaning.[17] The language of the Volcker Rule exempts general account and separate account investment activities from both the proprietary trading prohibition and the covered funds prohibition.

4. Insurance Company Investments in Covered Funds

Valid policy reasons support the conclusion that the Section 13(d)(1)(D) and Section 13(d)(1)(F) exemptions apply to all insurance company investment activities, including investing in covered funds to the extent permitted by applicable insurance investment laws.

First, insurance company investments in covered funds and other alternative asset classes provide significant benefits to the insurance company. For example, insurance company investments in covered funds provide insurance companies with an effective means for diversifying their portfolio holdings. This diversification benefit is even more evident when one considers that insurance companies are long-term buy-and-hold investors in a variety of covered funds that, although far from "traditional" private equity and hedge funds, could nevertheless be considered covered funds for purposes of the Proposed Rules. These funds include funds which invest in, for example, private

[17] *See id*, § 47.2, at 279.

placement and mezzanine debt, commercial mortgages and commercial real estate. Investing in a variety of covered funds and asset classes is a fundamental strategy for an insurance company to diversify its portfolio holdings and minimize correlation with corporate bonds and other forms of debt which form insurance companies' largest holdings.

Second, investments in covered funds allow an insurance company to more effectively align its income stream and the duration of its asset base (*e.g.*, interests in private equity and other covered funds) with its long-dated liabilities (*e.g.*, policy claims against the insurance company). Such effective asset-liability management clearly helps to promote, and indeed is essential to, the safety and soundness of the insurance company and, indirectly, its affiliated IDI, if it has one.

Third, investing in covered funds allows insurance companies to access world-class asset managers and potentially earn higher rates of return, with comparatively lower volatility when compared to direct investments in equities. If insurance companies affiliated with IDIs were not allowed to invest in covered funds, it would be more difficult for these insurance companies to engage in prudent long-term investing and asset-liability management in accordance with long-standing practices.

5. Conflict with Goal of Safety and Soundness

As discussed above, insurance company investment laws have been designed over many years by authorities with in-depth experience and expertise in the operation of insurance companies. The goal of these investment laws is to promote the safety and soundness of the insurance company. Among other prudential objectives promoted by these investments laws are the diversification of risk through varied asset classes and the availability of long-term asset classes to assist insurance companies in asset-liability management. It would run counter to the Volcker Rule's underlying purpose of promoting safety and soundness to deny insurance companies affiliated with an IDI the benefit of investments laws that are specifically designed to conform to the insurance business model and to promote the safety and soundness of insurance companies. It would be anomalous and ill-conceived to implement the Volcker Rule in a fashion that provides exemptions for insurance companies from the short-term proprietary trading prohibition in the Volcker Rule (insurance companies do not engage in the proprietary trading activities with which Congress was concerned) but not from the covered fund prohibition, where the investments are in fact very important tools for insurance companies to prudently manage their asset and liability requirements. If insurance companies affiliated with banking entities were denied investment opportunities that are available to other insurance companies that are not subject to the Volcker Rule, the safety and soundness of these insurance companies (and indirectly their affiliated IDIs) will be adversely affected.

IV. BOLI and Unregistered Separate Accounts

A. BOLI

We appreciate that §__14(a)(1) of Subpart C of the Proposed Rules includes an exemption from the covered funds prohibition for the acquisition or retention by a banking entity "of any ownership interest in or acting as sponsor to" a separate account used to purchase BOLI. However, it appears that the focus on the safety and soundness of banking organizations as purchasers of BOLI, which underlies the Agencies' exemption of BOLI under Section 13(d)(1)(J) of the Volcker Rule, may have resulted in incomplete consideration of the vital importance of insurance companies being able to continue to offer the full range of insurance products, not limited to BOLI, that rely on unregistered insurance company separate accounts. Thus, as we discuss below, we request that the Agencies confirm that insurance companies will be permitted to provide unregistered separate account products offered and maintained in accordance with applicable insurance law.

B. Unregistered Separate Accounts

Although the Proposed Rules expressly exempt the purchase of BOLI by a banking entity through a separate account, Subpart C of the Proposed Rules does not include an express exemption for the offering of other variable insurance products supported by unregistered separate accounts by an insurance company that is a banking entity within the definition of the Volcker Rule. We request that the Agencies confirm that unregistered separate accounts offered and maintained in accordance with applicable insurance law are not subject to the Volcker Rule's prohibitions on sponsorship of or investments in covered funds.

In addition to separate accounts that support BOLI, there are other separate accounts that rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act and hence could be deemed "covered funds" for purposes of the Proposed Rules. Although certain separate accounts have historically been deemed "funds" for purposes of the Investment Company Act, and required to register thereunder, because of a federal securities law policy interest in protecting *public* purchasers of separate account products, such as retail variable annuities,[18] these separate accounts have *not* historically been deemed funds for insurance purposes.[19] Nevertheless, if one took the position that

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[18] *See* Prudential Ins. Co. of Am. v. Sec. & Exch. Comm'n, 326 F.2d 383, 384 (3d Cir. 1964) (addressing the question of whether the Investment Company Act applies to the sale of variable annuity contracts supported by separate accounts to members of the "public").

[19] As we have discussed previously, a separate account is *not* a separate legal entity from the insurance company, and is instead simply an account on an insurance company's books that is established to hold assets supporting specific insurance policies. *See* Letter from the Roundtable, to the FSOC, Nov. 10, 2010, *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs10/FSOCLetter-

unregistered separate accounts could in fact be deemed "covered funds" for purposes of the Proposed Rules, one would then need to inquire whether an insurance company could be deemed to be the "sponsor" of the unregistered separate account within the meaning of the Volcker Rule.

The special definitional elements of the term "sponsor" in the Volcker Rule presuppose that (i) the fund is a separate legal entity from the sponsor and (ii) the sponsor maintains one of the three statutorily specified relationships with the separate legal entity. An insurance company does not "sponsor" a separate account within the special meaning of this term as defined in the Volcker Rule. A separate account simply represents a specified pool of assets on the balance sheet of an insurance company that supports a particular policy claim on the insurance company, and is not a separate legal entity from the insurance company itself. Thus, a separate account does not constitute a separate legal entity of the kind clearly envisioned as a "fund" by the Volcker Rule. Moreover, an insurance company does not possess any of the three specified elements of the definition of "sponsor" because it does not "serve as a general partner, managing member or trustee" of an unregistered separate account; nor does it "select or control . . . a majority of the directors, trustees or management" of an unregistered separate account; nor does it "share" a name with a separate account.

To interpret the term "sponsor" otherwise would lead to the unintended result that significant parts of the ordinary business of life insurance companies would be prohibited, such as the provision of corporate-owned life insurance to the full range of non-banking entity corporations large and small, private placement variable life insurance to individual customers, or the provision of group variable annuity products that are used to support pension plan obligations of an insurance company's corporate customers. We therefore request that the Agencies confirm that all separate accounts maintained in accordance with applicable insurance laws are allowed as activities on behalf of customers and will not be subject to the prohibition in the Proposed Rules against sponsoring and investing in covered funds.[20]

VolckerStudyNovember52010.pdf. Assets held in a separate account can only satisfy the claims of contract holders who hold variable life insurance policies and annuity contracts that are stated to be supported by the relevant separate account. Under insurance law, the contract holders do not legally own such assets and the assets of a separate account are considered to be assets of the insurance company. The assets are not subject to the claims of the general creditors of the insurance company or any other part of the company's business. Thus, separate accounts are not, and have never been considered, "funds" for purposes of insurance law.

[20] Because we believe the language of the Volcker Rule is clear that insurance companies cannot be deemed to "sponsor" separate accounts within the meaning of that word in the Volcker Rule, we have not requested that the Agencies exempt all insurance products supported by such separate accounts under Section 13(d)(1)(J) of the Volcker Rule, on the basis that these products promote the safety and soundness of insurance companies that are banking entities. However, we believe that there is ample

V. Permitted Subsidiaries of an Insurance Company

Various insurance laws allow an insurance company to invest in or organize subsidiaries.[21] These subsidiaries may invest in securities and other instruments that are authorized as investments of the parent insurance company. Section 13(d)(1)(F) of the Volcker Rule permits affiliates of regulated insurance companies to purchase, sell, acquire, or dispose of assets so long as such activities are solely for the general account of the regulated insurance company. However, this provision would be nullified if the affiliate, in this case, a subsidiary of the insurance company, were itself considered to be a covered fund sponsored by the insurance company, making the sponsorship prohibited under § __.10(a) of the Proposed Rules.

We therefore request that the Agencies revise the Proposed Rules to allow an insurance company to organize or invest in a subsidiary for the purpose of making investments, as permitted under applicable insurance law, without that subsidiary being deemed a covered fund for purposes of the Proposed Rules. In recognition of the fact that there may be a concern if interests in the investment subsidiary are owned by entities unaffiliated with the insurance company, we propose that the exemption apply only to subsidiaries that are wholly owned by the insurance company or entities that are affiliates of the insurance company. To implement this exemption, we request that the Agencies specifically exclude insurance company subsidiaries permissibly established under applicable insurance law from the definition of "covered fund."

VI. General Account and Separate Account Exemptions

As we have discussed, we believe that fulfillment of the statutory mandate to accommodate the business of insurance requires that the Agencies extend the General Account and Separate Account Exemptions to insurance company covered fund investment activities. While we believe that by definition all insurance company investment activity should qualify for either the General Account Exemption or the Separate Account Exemption or a combination of the General Account and Separate Account Exemptions,[22] and while we believe it is the statutory intent for all insurance company investment activity to so qualify, the definition of "separate account" as currently drafted leaves open the possibility that certain insurance company investment

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support for the view that Section 13(d)(1)(J) of the Volcker Rule provides a sound basis for exempting all such insurance products, including BOLI.

[21] *See* New York Insurance Law Section 1701(a) (permitting a life insurance company to "invest in … subsidiaries engaged" in lawful business activities, including investing); *see also* Connecticut Insurance Code Section 38-102d(a)(2); New Jersey Insurance Code Section 17B:20-4(d).

[22] All insurance company investment activity must be conducted either through the general account or a separate account of the insurance company.

activities conducted through separate accounts might fail to qualify for either the General Account or Separate Account Exemption. We request that the Agencies amend the Proposed Rules in order to remove this possibility.

Under the Separate Account Exemption, § __.6(b)(2)(iii)(C) provides that the purchase or sale of a covered financial position on behalf of an insurance company will only be considered to be "on behalf of customers" if:

(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**.

We are concerned that the clause "and not the insurance company" could inadvertently make certain types of insurance company investment activities, such as the allocation of "seed money" by an insurance company to a separate account or the offering of certain non-variable separate account contracts by an insurance company, ineligible for the Separate Account Exemption since profits and losses from some assets may be viewed as inuring to the benefit or detriment of the insurance company. Furthermore, if these investment activities were conducted with respect to "legally segregated" assets allocated to a separate account, the assets would not be "general account" assets and thus the investment activity would fail to qualify for the General Account Exemption. This would create a gap between the coverage of the General Account Exemption and the Separate Account Exemption with the result that investment activity authorized under applicable insurance law would be subject to the Volcker Rule prohibitions, which is contrary to the intent of the Volcker Rule.

State insurance law, for example, permits an insurance company to allocate "seed money" to a separate account to facilitate its initial operations.[23] Although this seed money is typically returned to the insurance company soon after it is allocated to the separate account, and although applicable insurance law may require that the seed money itself be subject to quantitative and qualitative limitations applicable to general account investments,[24] the requirement in §__.6(b)(2)(iii)(C) that separate account profits and losses not inure to the benefit or detriment of the insurance company could be interpreted to disqualify a separate account from being eligible for the Separate Account Exemption if it holds seed money allocated by the insurance company. Such allocations to separate accounts are an important part of a separate account's initial operations, and we believe

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[23] *See, e.g.*, New York Insurance Law Section 4240(a)(3) (permitting a life insurance company to "allocate amounts to a separate account to facilitate its initial operations," the amounts of which are considered "seed money"); *see also* Connecticut Insurance Code Section 38-433(a)(6); New Jersey Insurance Code Section 17B:28-9(c).

[24] *See, e.g.*, New York Insurance Law Section 4240(a)(3).

that both separate accounts which include an allocation of seed money and separate accounts which formerly included an allocation of seed money qualify for an exemption.

Insurance companies also create separate accounts to support certain non-variable separate account contracts, such as book value,[25] market value-adjusted, or modified guaranteed[26] contracts. For these types of separate account contracts, applicable accounting rules may require that the insurance company bear the risk of credit-related asset losses or fair value losses of the separate account assets themselves.[27] This is because the insurance company may be required to fund the difference between the actual separate account asset market value and the contractual guarantee value. These contracts may also provide that some of the profits or losses arising from the investment of the separate account assets may inure to the benefit or detriment of the insurance company itself, rather than the policyholder. Because these contracts may be structured such that the insurance company bears risks associated with changes in the value of the separate account assets, it is possible that insurance company investment activity with respect to these separate accounts would fail to qualify for the Separate Account Exemption.

In order to eliminate this potential gap between insurance company investment activities that qualify for the General Account and Separate Account Exemptions, we request that the Agencies amend the definition of "separate account" in §__ .2(z) of the Proposed Rules as follows (proposed additional language in **bold**)[28]:

(z) *Separate account* means an account established and maintained by an insurance company subject to regulation by a State insurance regulator or foreign insurance regulator under which**:**

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[25] Book value separate account contracts provide guaranteed, fixed rate returns to policyholders. These fixed rate returns may be based on the performance of external indices, such as the Standard & Poors 500 index.

[26] Modified guaranteed separate account contacts are deferred annuity contacts which are guaranteed to retain a certain value by the insurance company if the contract is held by the policyholder for a certain period of time.

[27] For example, because the insurance company bears the risk of a loss in value of separate account assets supporting modified guaranteed annuity contracts, state insurance law and regulation generally requires that the separate accounts assets be invested in accordance with the insurance company's general account investment laws. *See* National Association of Insurance Commissioners, Modified Guaranteed Annuity Model Regulation, Model 255, § 9.D.

[28] As an alternative, the Agencies could eliminate § __.6(b)(2)(iii)(C) from the Separate Account Exemption. This approach would conform the definitions of "general account" and "separate account" in the Proposed Rules, and would better align the Separate Account Exemption with the types of separate account products that insurance companies may permissibly offer under state insurance law.

(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.

The addition of condition (2) to the "separate account" definition makes this definition track all the conditions in the Separate Account Exemption, specifically the condition in §__.6(b)(2)(iii)(C). This change assures that there can be no gap – all insurance company investment activities permissible under applicable insurance law will qualify for one of the Separate Account Exemption or the General Account Exemption. For example:

- A variable separate account with "legally segregated assets" (for which there is no insurance company "seed money") will remain eligible for the Separate Account Exemption.

- A separate account with "seed money" will not be a "separate account" under this amended definition since it will fail condition (2); since the assets will not be allocated to a "separate account," the assets will be "general account" assets as defined in § __3(c)(5) of the Proposed Rules and be eligible for the General Account Exemption. This will be true whether or not the separate account assets are "legally segregated."

- A separate account that supports the kinds of non-variable separate account contracts described above (where profits and losses inure to the benefit or detriment of the insurance company) will not be a "separate account" under this amended definition since it will fail condition (2); since the assets will not be allocated to a "separate account," the assets will be "general account" assets as defined in § __3(c)(5) of the Proposed Rules and be eligible for the General Account Exemption. This will be true whether or not the separate account assets are "legally segregated."

- A separate account with assets that are not "legally segregated" will be "general account" assets as defined in § __3(c)(5) of the Proposed Rules and be eligible for the General Account Exemption.

VII. Compliance Program

A. Request for Exemption

Sections __.7 and __.15 of the Proposed Rules require banking entities engaged in any proprietary trading activity or covered fund activity to comply with certain enumerated reporting and recordkeeping requirements, as well as such other reporting requirements that the Agencies may impose at a later date. In addition, Subpart D, §__.20 of the Proposed Rules requires each banking entity to develop a program designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund investments. Because insurance companies have long been subject to comprehensive regulation and oversight of their permitted investment activities under applicable insurance law, we request that insurance companies which engage in proprietary trading or covered fund activities be exempted from the reporting and recordkeeping requirements of §§ __.7, __.15 and __.20 of the Proposed Rules, including the compliance program requirements of Subpart D. As noted below, this exemption is warranted in light of (i) insurance law regimes, which already impose comprehensive regulatory and reporting requirements on insurance company activities and (ii) the Volcker Rule's explicit recognition of these insurance law regimes.

B. Existing Regulatory Regimes

Applicable insurance laws typically require insurance companies to adhere to a comprehensive set of regulations concerning the types and amounts of investments they may make. Although the exact contours of these regimes vary from state to state and jurisdiction to jurisdiction, they may impose the following requirements:

- Qualitative and Quantitative Limits – Applicable insurance law may impose limits on the types of asset classes that the insurance company may invest in and the amount of each asset class that the insurance company may hold.

- Written Plan – Applicable insurance law may require that an insurance company's board of directors adopt a written plan for the acquisition and retention of investments by the insurance company. These plans often include requirements concerning the quality and maturity of the assets being invested in, as well as requirements concerning the diversification of the insurance company's investment portfolio. The insurance company's board of directors or investment committee is typically required to monitor the portfolio to determine whether the asset composition of the portfolio and the insurance company's investment activities are consistent with the written investment plan.

- Periodic Examination – Insurance regulators periodically examine the insurance company to determine whether the insurance company's investments comply with applicable insurance law and any such written investment plan.

C. Statutory Deference to Existing Insurance Law and Regulation

Section 13(d)(1)(F) of the Volcker Rule explicitly recognizes the validity of insurance investment regulatory schemes. By permitting an insurance company to engage in activities through its general account if such activities are conducted in compliance with, and subject to, applicable insurance law, regulations and written guidance, the Volcker Rule recognizes that a state or foreign jurisdiction's composite body of insurance law and regulation functions as a valid regime governing the conduct of investment activities by insurance companies. By mandating that the Agencies permit such activity only so long as the relevant body of insurance law and regulation has not been determined to be insufficient by the appropriate Federal banking agencies, Section 13(d)(1)(F) recognizes the validity of existing insurance law and regulation. By mandating that an insurance company conduct its permitted activities in compliance with applicable law and regulation, the Volcker Rule specifically contemplates that when an insurance company engages in permitted activities, it does so under the purview of the applicable insurance law, regulation and written guidance, rather than the regulations and guidance of the Agencies. This analysis applies with equal weight to the regulations and guidance governing the insurance company's conduct of the permitted activities as it does to regulations and guidance governing compliance with the activities restrictions themselves.

We thus submit that in order to adhere to the statutory mandate to appropriately accommodate the business of insurance, the Agencies should exempt insurance company activities permitted under the Proposed Rules from §§ __.7, __.15 and __.20 of the Proposed Rules, including the compliance program requirements of Subpart D. This exemption should apply to all permitted insurance company proprietary trading and covered fund activities unless and until the Federal banking agencies determine that a particular state or foreign jurisdiction's insurance law is insufficient to protect the safety and soundness of the insurance company or the financial stability of the United States, in which case the exemption would no longer apply to proprietary trading and covered fund activity conducted by insurance companies pursuant to that specific body of insurance law.

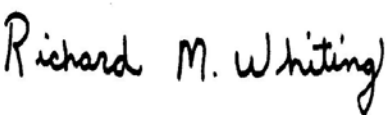
VIII. Conclusion

We conclude by reiterating that the purpose and text of the Volcker Rule provide a clear mandate to the Agencies to appropriately accommodate the business of insurance. As we have discussed, proper accommodation of the business of insurance requires that insurance companies affiliated with banking entities be able to continue their general and separate account investment activities under the purview of the Volcker Rule's statutory and regulatory framework. Proper accommodation of the business of insurance also requires that the Agencies recognize the validity of the existing insurance law regulatory regime with respect to insurance company investment activities, as the validity of these regimes is directly reflected in the text of the Volcker Rule itself. Because these

insurance law regulatory regimes are designed to protect and promote the safety and soundness of regulated insurance companies, these regimes already achieve the objective for which the Volcker Rule itself was intended. As we have discussed, we believe that the mandate to appropriately accommodate the business of insurance and the existing insurance law framework is linked to the unique characteristics of insurance companies themselves which we have discussed here. As we have noted, appropriate accommodation of the unique asset-liability structures of insurance companies, which emphasize long-term liabilities, requires insurance companies be able to invest in long-term assets which can effectively support their long-term liabilities, thus allowing for optimal asset-liability management that promotes the safety and soundness of the insurance company and its affiliated IDI.

We look forward to additional discussions with the Agencies as the process of implementing the Volcker Rule continues. Through further discussion, we hope to provide the Agencies and their staff with additional information about the business of insurance generally, the nature and extent of existing insurance law regulatory regimes, and the unique characteristics of insurance companies themselves. As the Volcker Rule implementation process continues, further dialogue between insurance companies and the Agencies will increase the likelihood that the final regulatory framework adopted by the Agencies will promote the safety and soundness of both insurance companies affiliated with banking entities and the U.S. financial system as a whole, while allowing these insurance companies to continue to provide client-oriented financial services that are crucial to the health of the U.S. economy.

We thank the Agencies for the opportunity to comment. If you have any questions, please feel free to contact me or Peter Freeman at (202) 289-4322.



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Appendix A: Proposed Amendment to Subpart C

[ ] 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.

Appendix B: Responses to Specific Questions

Question 128: Is the proposed rule's exemption of trading for separate accounts by insurance companies effective? If not, what alternative would be more appropriate? Does the proposed exemption sufficiently address the variety of customer-driven separate account structures typically used? If not, how should it address such structures? Does the proposed exemption sufficiently address the variety of regulatory or supervisory regimes to which insurance companies may be subject?

Please see sections II.B, III, IV, and VI of our letter.

Question 129: What impact will the proposed rule's implementation of the exemption have on the insurance activities of insurance companies affiliated with banking entities? If such impacts are negative, how could they be mitigated or eliminated in a manner consistent with the purpose and language of the statute?

Please see sections III.A.4 and III.A.5 of our letter.

Question 132: Should any of the statutory requirements for the exemption be further clarified in the proposed rule? If so, how? Should any additional requirements be added? If so, what requirements and why?

Please see sections III, IV, V, and VI of our letter.

Question 133: Does the proposed rule appropriately and clearly define a general account for these purposes? If not, what alternative definition would be more appropriate?

Please see sections II.A and VI of our letter.

Question 134: For purposes of the exemption, are the insurance company investment laws, regulations, and written guidance of any particular state or jurisdiction insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States? If so, why?

As we note in section II.A of our letter, the Agencies have decided not to propose that the insurance company investment laws, regulations, and written guidance of a particular state or jurisdiction are insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States. We support this decision, and reiterate our belief that state insurance law regulatory regimes are robustly designed and implemented, and have proven their ability to protect the safety and soundness of insurance companies and the financial stability of the United States as a whole.

Question 135: What impact will the proposed rule's implementation of the exemption have on the insurance activities of insurance companies affiliated with banking entities?

If such impacts are negative, how could they be mitigated or eliminated in a manner consistent with the purpose and language of the statute?

Please see sections III.A.4 and III.A.5 of our letter.