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VIA ELECTRONIC SUBMISSION

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Docket ID OCC-2011-0001

Jennifer J. Johnson
Secretary of the Board
Federal Reserve Board
20th and C Streets, N.W.
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Docket No. R-1410; RIN 7100-AD69

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
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Washington, D.C. 20429
Attention: Comments
RIN 3064-AC56

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
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Attention: OTS-2011-0004

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
Proposed Rule Part 741 and 751

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
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Washington, D.C. 20549
File Number S7-12-11

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G Street, N.W.
Washington, D.C. 20552
Attention: Comments/RIN 2590-AA42

Re: Incentive-Based Compensation Arrangements

Ladies and Gentlemen:

The American Insurance Association ("AIA") appreciates the opportunity to comment on the proposed rule of the Agencies to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") regarding incentive-based compensation arrangements (the "Proposed Rule").[1] AIA represents approximately 300 major U.S. insurance companies that provide all lines of property-casualty insurance to U.S. consumers and businesses, writing more than $117 billion annually in premiums. Our members have a significant interest in the Agencies' Proposed Rule.

BACKGROUND

Section 956 of the Dodd-Frank Act requires the Agencies to prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a covered financial institution that the Agencies determine encourages inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss. The Agencies recognize that compensation arrangements are critical to the successful management of financial institutions. Such arrangements enable the institution to attract and retain skilled staff and promote organizational and individual employee performance. However, the Agencies also indicate that improperly structured compensation arrangements can provide incentives to take imprudent risks that are not consistent with the long-term health of the organization. The Agencies state that flawed incentive compensation practices in the financial industry contributed to the recent financial crisis. Accordingly, the Agencies believe that supervision and regulation of incentive compensation play an important role in helping ensure that incentive compensation practices at covered financial institutions do not threaten their safety and soundness, are not excessive, or do not lead to material financial loss.

Section 956 applies to "covered financial institutions."[2] A "covered financial institution" is defined to include the following types of institutions that have $1 billion or more in assets:

(A) A depository institution or depository institution holding company (as defined in the Federal Deposit Insurance Act ("FDIA");[3]
(B) A registered broker-dealer;
(C) A credit union;
(D) An investment adviser;
(E) The Federal National Mortgage Association ("Fannie Mae");
(F) The Federal Home Loan Mortgage Corporation ("Freddie Mac"); and
(G) Any other financial institution that the appropriate Federal regulators,

[1] 76 *Fed. Reg*. 21170 (April 14, 2011). The Agencies include the Office of the Comptroller of the Currency ("OCC"), Federal Reserve Board ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), Office of Thrift Supervision ("OTS"), National Credit Union Administration, Securities and Exchange Commission and Federal Housing Finance Agency.
[2] Dodd-Frank Act, Pub. L. 111-203, § 956(e)(2).
[3] 12 U.S.C. § 1813.

jointly, by rule, determine should be treated as a covered financial institution for these purposes.

THE PROPOSED RULE

The Proposed Rule prohibits incentive-based compensation arrangements that encourage executive officers, employees, directors, or principal shareholders ("covered persons") to expose a covered financial institution to inappropriate risks by providing the covered person excessive compensation. A covered financial institution is also prohibited from establishing or maintaining any incentive-based compensation arrangements for covered persons that encourage inappropriate risks by the covered financial institution that could lead to material financial loss. Further, the Proposed Rule also requires deferral of a portion of incentive-based compensation for executive officers of larger covered financial institutions. The board of directors or a board committee at covered financial institutions with total consolidated assets of $50 billion or more is required to identify those covered persons that have the ability to expose the institution to possible substantial losses, and approve the incentive-based compensation arrangement for such individuals. Covered financial institutions are required to maintain policies and procedures appropriate to their size, complexity, and use of incentive-based compensation to help ensure compliance with these requirements and prohibitions. Covered financial institutions must also provide certain information to their appropriate Federal regulators concerning their incentive-based compensation arrangements for covered persons.

The Act also requires the Agencies to ensure that any standards adopted with regard to excessive compensation under the Dodd-Frank Act are comparable to the compensation-related safety and soundness standards applicable to insured depository institutions under section 39 of the FDIA[4] and to take the compensation standards described in section 39 of the FDIA into consideration in establishing compensation standards under section 956. Accordingly, the Proposed Rule supplements existing rules and guidance adopted by the Agencies regarding compensation and incentive-based compensation.[5] These include the Banking Agency Guidance and the Standards for Safety and Soundness adopted by the Federal banking agencies.[6]

[4] 12 U.S.C. § 1831p-1(c).
[5] Guidance on Sound Incentive Compensation Policies, 75 *Fed. Reg.* 36395 (June 25, 2010).
[6] 60 *Fed. Reg.* 35674 (July 10, 1995), as amended at 61 *Fed. Reg.* 43948 (August 27, 1996).

SCOPE OF COVERAGE

The Federal Register preamble to the Proposed Rule states that in the case of the Federal Reserve, a covered financial institution includes a bank holding company and subsidiaries of the institution.[7] However, in the case of the OTS, the preamble to the Proposed Rule indicates that a covered financial institution includes an operating subsidiary of a Federal savings association as defined in 12 C.F.R. § 559.2. Accordingly, under the Federal Reserve's Proposed Rule, a property-casualty insurance company that is a subsidiary of a bank holding company would be a covered financial institution and subject to the Proposed Rule, but a property-casualty insurance company that is a subsidiary of a savings and loan holding company would not be a covered financial institution. For the reasons presented below, AIA believes that the Proposed Rule should not apply to bank holding company subsidiaries that are insurance companies. Accordingly, the Federal Reserve should adopt the same rule as the OTS has proposed regarding the definition of covered financial institutions.[8]

PROPERTY-CASUALTY INSURANCE COMPANIES SHOULD NOT BE COVERED FINANCIAL INSTITUTIONS

The Agencies state that section 956 of the Dodd-Frank Act requires the Agencies to prohibit incentive-based payment arrangements at a covered financial institution that the Agencies determine encourages inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss. AIA believes that property-casualty insurers present a low risk profile to our nation's financial system. Accordingly, property-casualty insurers engaged in traditional insurance activities should never present a significant risk to the financial stability of the United States. We suggest that it is important for the Agencies to factor this aspect of the property-casualty industry into their deliberations regarding what types of institutions are to be covered financial institutions under the final rule.

As the Agencies are aware, property-casualty insurers are extensively regulated under state law and closely supervised by state insurance authorities. State insurance regulators maintain and apply rigorous financial supervisory standards designed to ensure that property-casualty insurers remain in financially sound condition. The comprehensive financial regulatory architecture for property-casualty insurers stems from the industry's "inverted cycle of production" business model, which is premised upon collecting sufficient premiums in advance to fund covered claims, but where the actual cost of the insurance product is unknown at the time of purchase and depends upon the probability and severity of the occurrence of covered claims. The insurance business model also helps shield property-casualty insurers from the so-

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[7] 76 *Fed. Reg.* at 21174. The Board also regards state member banks, state-licensed uninsured branches and agencies of foreign banks and U.S. operations of foreign banks with more than $1 billion of U.S. assets that are treated as bank holding companies to be covered financial institutions.

[8] Under OTS rules, an operating subsidiary may engage in any activity that a federal savings and loan association may engage in directly. 12 C.F.R. § 559.3(e). Federal savings and loan associations are not authorized to underwrite property-casualty insurance, and therefore a property-casualty insurance company may not be an operating subsidiary.

called "customer runs" frequently associated with other types of financial products and services. Because insurance payments depend on the occurrence of a contractually-covered claim, as a practical matter, insurance consumers do not have "on-demand" access to insurance assets as they would with other financial institutions that do not operate according to an inverted cycle of production.

We believe that any proposal to apply section 956 of the Dodd-Frank Act to property-casualty insurance companies that are subsidiaries of bank holding companies must take into account the significant differences between the insurance business and the business of banking, as well as the extensive nature of state insurance regulation. As the Agencies are aware and as noted previously, property-casualty insurance companies are subject to comprehensive regulation under state insurance law and regulation. These state requirements reflect the unique nature of the insurance business and ensure that insurers will not engage in activities, including compensation arrangements, that expose the company to inappropriate risks by providing excessive compensation or that could lead to material financial loss. AIA believes that imposition of bank-centric compensation requirements to property-casualty insurers within the consolidated entity is highly inappropriate in view of the widespread differences between the insurance and banking industries. Because property-casualty insurance companies are subject to extensive supervision and regulation by state authorities, including review of compensation arrangements, AIA believes that the Federal Reserve should not apply the Proposed Rule to bank holding company subsidiaries that are property-casualty insurance companies.

Our position is consistent with the language of the Dodd-Frank Act, which does not include subsidiaries in the definition of "covered financial institution."[9] Indeed, when Congress intended to cover subsidiaries in the Dodd-Frank Act, it knew how to do it. In section 115 of the Dodd-Frank Act, Congress enhanced supervisory and prudential standards for nonbank financial companies and certain bank holding companies supervised by the Federal Reserve. In directing the Financial Stability Oversight Council ("FSOC") to conduct a study on contingent capital requirements for certain nonbank financial companies and bank holding companies, Congress instructed the FSOC to consider capital requirements applicable to nonbank financial companies supervised by the Federal Reserve or certain bank holding companies "and subsidiaries thereof."[10] In section 165 of the Dodd-Frank Act, Congress provided that following FSOC's submission of its report on contingent capital, the Federal Reserve may issue regulations that require certain nonbank financial companies and bank holding companies to maintain a minimum amount of contingent capital.[11] Congress also directed the Federal Reserve to consider capital requirements applicable to nonbank financial companies supervised by the Federal Reserve or certain bank holding companies "and subsidiaries thereof."[12]

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[9] Dodd-Frank Act § 956(e)(2).
[10] Dodd-Frank Act § 115(c)(3)(B)(iii).
[11] Dodd-Frank Act § 165(c)(1).
[12] Dodd-Frank Act § 165(c)(2)(D).

Additionally, in sections 1044, 1045 and 1046 of the Dodd-Frank Act, Congress clarified pre-emption standards that apply to "national banks and subsidiaries," "nondepository institution subsidiaries" of national banks, and "Federal savings associations and subsidiaries." Congress intentionally did not include subsidiaries in the definition of covered financial institution when it enacted section 956. We believe it is contrary to the clear, express language of the Dodd-Frank Act for the Federal Reserve by rule to expand the statutory definition of "covered financial institution" to include subsidiaries of bank holding companies that are not depository institutions.[13]

Our position is also supported by the legislative treatment of the business of insurance in the Dodd-Frank Act, which recognized important differences between insurers and other financial institutions throughout the legislation. The Dodd-Frank Act's recognition of the material distinction between insurance companies and other financial firms is readily apparent in the detailed risk-related designation process for nonbank financial companies in Title I, as well as in Title II's express language providing that insurance entities are not subject to the orderly liquidation process established in that title even if they are part of a holding company group that may otherwise be subject to Title II liquidation.[14] Accordingly, AIA strongly believes that the Federal Reserve should not include property-casualty insurers that are subsidiaries of bank holding companies as covered financial institutions in its final rule.

THE PROPOSED RULE SHOULD NOT APPLY TO PROPERTY-CASUALTY INSURANCE COMPANIES THAT ARE BANK HOLDING COMPANIES OR SAVINGS AND LOAN HOLDING COMPANIES

AIA also believes that the Federal Reserve and OTS should not treat property-casualty insurers that may be bank holding companies or savings and loan holding companies as covered financial institutions. Although a literal reading of the definition of "covered financial institution" in section 956 may lead to the conclusion that the term includes a property-casualty insurance company that is a bank holding company or a savings and loan holding company, AIA believes that such a reading conflicts with, and is preempted by, the McCarran-Ferguson Act (the "McCarran Act"), which recognizes the primary role of the states in regulating the business of insurance expressly delegated by Congress.[15]

The McCarran Act provides as follows:

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[13] *See Sorenson v. Secretary of Treasury*, 475 U.S. 851, 860 (1986) ("The normal rule of statutory construction assumes that identical words used in different parts of the same act are intended to have the same meaning.") (internal citations omitted).

[14] Dodd-Frank Act §§ 113 and 203(e). *See also* 156 Cong. Rec. S5902 (July 15, 2010) ("Nonbank Financial Companies") (colloquy between Senator Collins and Chairman Dodd regarding the industry-specific considerations for insurance in the Section 113 designation process); Senate Banking Committee Report No. 111-176, at 64 (April 30, 2010) (describing the assessment process under Title II, the report states that "certain types of financial companies such as insurance companies and other financial companies that may present lower risk to U.S. financial stability (as indicated, for example, by higher capital, lower leverage, or similar measures of risk as appropriate depending on the nature of the business of the financial companies) relative to other types of financial companies should be assessed at a lower rate.").

[15] 15 U.S.C. § 1012.

Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) *State regulation.* The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
(b) *Federal regulation.* No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

Congress enacted the McCarran Act to allow the states to regulate the business of insurance "free from inadvertent preemption by federal statutes of general applicability."[16] The Act reverses the usual rules for preemption, creating a "clear-statement rule . . . that state laws enacted 'for the purpose of regulating the business of insurance' do not yield to conflicting federal statutes unless a federal statute specifically requires otherwise."[17] To determine whether the McCarran Act pre-empts section 956 of the Dodd-Frank Act, it is necessary to consider the following:

1. Whether section 956 of the Dodd-Frank Act "specifically relates to the business of insurance";
2. Whether state laws regulating the operations of insurance companies, including compensation arrangements, were enacted "for the purpose of regulating the business of insurance";
3. If section 956 does not specifically relate to the business of insurance, whether the section invalidates, impairs or supersedes state laws regulating the business of insurance.

Section 956 does not specifically relate to the business of insurance. Moreover, state laws and regulation address compensation arrangements and practices of insurance companies. Indeed, in one instance the state insurance authority denied an application which it determined involved excessive compensation.[18] AIA believes that by encroaching on the authority of state

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[16] *Merchants Home Delivery Serv., Inc. v. Frank B. Hall & Co.*, 50 F.3d 1486, 1488-89 (9th Cir. 1995).
[17] *United States Dep't. of the Treasury v. Fabe*, 508 U.S. 491, 507 (1993).
[18] *See* Notice of Intent to Deny the Application of Anthem, Inc. to Acquire Control of BC Life and Health Insurance Company, a California Insurer and an indirect subsidiary of WellPoint Health Networks Inc., Filed Pursuant to California Insurance Code Section 1215.2, John Garamendi, Insurance Commissioner (July 23, 2004) ("I find that

insurance regulators to supervise the activities of insurance companies subject to their jurisdiction, section 956 of the Dodd-Frank Act invalidates, impairs or supersedes state laws regulating the activities of property-casualty insurance companies.

Regulations adopted under section 956 will inevitably displace state insurance supervision of insurance company compensation arrangements and render them ineffective. Moreover, by displacing state law, the Proposed Rule would frustrate and interfere with state administrative procedures that establish and require enforcement over insurance industry compensation arrangements. Because applying section 956 to insurance companies that are bank holding companies or savings and loan holding companies would inappropriately intrude upon the authority of states to regulate the business of insurance and to determine the manner in which insurers may establish compensation arrangements, we conclude that applying section 956 of the Dodd-Frank Act to insurance companies that are bank holding companies or savings and loan holding companies is not permitted by the McCarran Act.

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AIA appreciates this opportunity to provide its views on the Agencies' Proposed Rule and would be pleased to discuss our comments further with you.

Respectfully submitted,

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the interests of BC Life & Health's policyholders would be prejudiced by Anthem/Wellpoint's obligation to pay these excessive compensation packages.")