



**ICIMutual**  
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January 9, 2015

Alfred M. Pollard, General Counsel  
Attention: Comments/RIN 2590-AA39  
Federal Housing Finance Agency  
400 Seventh Street, SW – Eighth Floor  
Washington, D.C. 20024

Re: Notice of Proposed Rulemaking and Request for Comments  
Members of Federal Home Loan Banks (RIN 2590 – AA39)

Dear Mr. Pollard:

I write on behalf of ICI Mutual Insurance Company, a Risk Retention Group (“ICI Mutual” or “Company”), in response to the notice by the Federal Housing Finance Agency (“FHFA”) of a proposed revision to its membership regulations (“Proposed Rule”).<sup>1</sup> As here relevant, the Proposed Rule would add a provision whose “principal effect ... would be to prohibit captive insurers from becoming Bank members” (“Captive Prohibition”).<sup>2</sup> ICI Mutual, as a Federal Home Loan Bank (“Bank”) member in good standing, appreciates the opportunity to comment on the Proposed Rule.

As discussed below, ICI Mutual is a broadly-owned risk retention group providing specialized insurance products for the American mutual fund industry, and is not the type of insurance company at which the Captive Prohibition is directed. Even so, under the current wording of the Proposed Rule, ICI Mutual may be at risk of being deemed a “captive” insurer so as to be subject to the Captive Prohibition. ICI Mutual takes no position as to the advisability of the FHFA adopting the Proposed Rule, or as to the advisability of the FHFA adopting the Captive Prohibition as a provision therein. However, if the FHFA does decide to proceed with the Proposed Rule and the Captive Prohibition, ICI Mutual would urge the FHFA to consider certain technical revisions to the Proposed Rule, as detailed in Part B below, in order to ensure that ICI Mutual and any similarly-situated insurance companies may remain Bank members.

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<sup>1</sup> Federal Housing Finance Agency, 79 Fed. Reg. 54848 (September 12, 2014) (Amending 12 C.F.R Part 1263).

<sup>2</sup> 79 Fed. Reg. 54848, at 54853.

***A. Background on ICI Mutual: Its Business, Structure and Reasons for Bank Membership***

Since its formation in 1987, ICI Mutual has provided directors and officers/errors and omissions liability insurance and certain other specialized liability insurance products to a subset of financial institutions—i.e., investment companies, institutional investment advisers, and other “eligible firms” (as defined in ICI Mutual’s by-laws) associated with the American mutual fund industry.<sup>3</sup> ICI Mutual currently provides these liability insurance products to eligible firms within approximately 120 “fund groups,” which number has remained relatively stable over time.<sup>4</sup> ICI Mutual is overseen by a board of directors, composed of up to twenty-five individuals, at least seventy-five percent of whom are directors, senior managers, or otherwise associated with member fund groups of the Company. Responsibility for day-to-day operations of the Company is delegated to the Company’s officers and full-time professional staff (currently numbering twenty-three). For more than twenty-five years, ICI Mutual has continued to pursue the mission for which it was originally formed—i.e., to serve as a limited purpose insurance carrier providing a stable, reliable, long-term source for specialized liability insurance products required by fund groups within the American mutual fund industry.<sup>5</sup> The Company believes that its existence has assisted in leveling the historic cyclical volatility in the commercial insurance marketplace for these specialized liability insurance products, and has thereby assisted not only its insured fund groups and the mutual fund industry generally, but American investors as a whole. ICI Mutual has been continuously rated “A” (Excellent) by A.M. Best, a nationally recognized statistical rating organization, since 1993, when ICI Mutual first became eligible for an A.M. Best rating.

ICI Mutual operates as a “risk retention group” pursuant to the federal Liability Risk Retention Act of 1986 (“LRRRA”).<sup>6</sup> As an insurance company organized under the laws of Vermont, ICI Mutual is regulated by the Vermont Department of Financial Regulation; as a risk

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<sup>3</sup> More specifically, these investment companies, institutional investment advisers and other “eligible firms” are members (or associate members) of the Investment Company Institute (“ICI”), the national association of U.S. investment companies (including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts). The ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their advisers, directors and shareholders.

<sup>4</sup> In the U.S. investment company industry, investment companies, institutional investment advisers and other institutional service providers to investment companies are generally associated with individual “fund groups.” There are approximately 260 “fund groups” which are members of the ICI. There are also some fund groups which are not members of the ICI. ICI Mutual insures only fund groups which are members of the ICI. The ICI has no ownership interest in ICI Mutual.

<sup>5</sup> ICI Mutual, through two non-insurance company subsidiaries (each of which is itself a corporation in good standing in its chartering jurisdiction), also provides certain insurance-related services to ICI Mutual and/or to fund groups. These services include underwriting and claims handling services for ICI Mutual, and risk management, risk prevention, insurance brokerage, and insurance educational services for ICI Mutual and/or for fund groups.

<sup>6</sup> 15 U.S.C. §§ 3901-06 (2006).

retention group, ICI Mutual is classified as one of a number of different types of “captive” insurance company permitted under Section 6001 of Title 8 of the Vermont Statutes.<sup>7</sup> Unlike certain other “captive” insurance companies (including those at which the Captive Prohibition appears to be directed),<sup>8</sup> ICI Mutual has no parent company. Rather, in accordance with the LRRRA, ICI Mutual “has as its owners only persons who comprise the membership” of ICI Mutual “and who are provided insurance” by ICI Mutual—i.e., ICI Mutual has as its owners only the approximately 120 “fund groups” referenced above. Pursuant to relevant provisions of ICI Mutual’s by-laws, no individual member fund group may have votes equal to five percent or more of the total votes of all member fund groups.

ICI Mutual applied for membership in the Federal Home Loan Bank of Boston in 2013. The Bank approved the Company’s application in April 2014, and the Company became a Bank member in May 2014. Bank membership provides ICI Mutual with a reliable source of temporary liquidity for ICI Mutual’s *own* operational needs as an insurance company—in particular, ICI Mutual contemplates that it may find it advisable to borrow from the Bank from time to time in order to “bridge” the period between the date that ICI Mutual disburses amounts that may be due to be paid on a large insurance claim and the date that ICI Mutual receives corresponding recoveries of these amounts from its independent third-party reinsurers.<sup>9</sup> Access

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<sup>7</sup> Section 6001 of Title 8 of the Vermont Statutes defines “captive insurance company” to mean any (1) “pure captive insurance company,” (2) “association captive insurance company,” (3) “sponsored captive insurance company,” (4) “industrial insured captive insurance company,” (5) “risk retention group,” or (6) “special purpose financial captive insurance company” which is formed or licensed under the provisions of Chapter 141 of Title 8 of the Vermont Statutes. The various types of captives are themselves defined in Section 6001, with “pure captive insurance company” defined to mean “any company that insures risks of its parent and affiliated companies [with “affiliated company” defined as “any company in the same corporate system as a parent, an industrial insured, or a member organization by virtue of common ownership, control, operation, or management”] or controlled unaffiliated business,” and “risk retention group” defined to mean “a captive insurance company organized under the laws of this State [i.e., Vermont] pursuant to the Liability Risk Retention Act of 1986, 15 U.S.C. § 3901 et seq., as amended, as a stock or mutual corporation, a reciprocal or other limited liability entity.”

<sup>8</sup> See 79 Fed. Reg. 54848, at 54853 & n.31 (“Captive insurers are typically formed by a company as a means of self-insuring certain risks associated with the business of the parent company or an affiliate.”).

<sup>9</sup> Among the factors that distinguish ICI Mutual from competitor insurance companies operating in the mutual fund industry is ICI Mutual’s willingness to write large policy limits for its insured fund groups. ICI Mutual’s willingness to write large limits provides insured fund groups with a “single-insurer” alternative for structuring their insurance programs that is separate and distinct from the “multiple-insurer” (or “layered”) approach available in the commercial insurance markets. Many fund groups value the single-insurer approach for its administrative convenience, and for the value that it offers to insureds in the claims-adjustment process. ICI Mutual manages and diversifies its own risk in issuing large limits by entering into reinsurance agreements with over two dozen highly-rated independent third-party reinsurers, many of whom have been long-time supporters of ICI Mutual, and all of whom value ICI Mutual for its underwriting and claims handling expertise in the specialized area of mutual fund industry risks.

ICI Mutual has historically experienced excellent results in recovering, in a timely fashion, all amounts due from its reinsurers on claims paid by ICI Mutual. The “reimbursement” nature of reinsurance can nevertheless create a timing issue—and thus, has the potential to create a temporary liquidity issue—for ICI Mutual, by

to the Bank as a reliable temporary liquidity facility reduces the risk to ICI Mutual of having to liquidate a significant portion of its own portfolio securities to pay an unusually large claim, and thereby reduces the risk of disrupting ICI Mutual's strategies for managing its investment portfolio, including the residential mortgage-backed securities contained therein.<sup>10</sup> This reliable access to the Bank as a source of temporary liquidity allows ICI Mutual to commit a larger portion of its investment portfolio to longer term securities, including residential mortgage-backed securities, than it would otherwise commit if this source of liquidity were not available.

### ***B. Comments on the Proposed Rule***

As detailed in this section, ICI Mutual is not the type of insurance company at which the Captive Prohibition is directed. Even so, under the current wording of the Proposed Rule, ICI Mutual may be at risk of being deemed a "captive" insurer so as to be subject to the Captive Prohibition. If the FHFA decides to proceed with the Proposed Rule and the Captive Prohibition, ICI Mutual would urge the FHFA to consider certain technical revisions in order to ensure that ICI Mutual and any similarly-situated insurance companies may remain Bank members.

#### ***1. ICI Mutual is not the type of insurance company at which the Captive Prohibition is directed.***

The Proposed Rule states that certain of its provisions, including the Captive Prohibition, are designed "to address supervisory concerns about certain institutions that are ineligible for Bank membership, but that are using captives as vehicles through which they can obtain Bank advances to fund their business operations."<sup>11</sup> The FHFA's concerns appear to focus primarily on

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reason of the fact that a relatively short period of time (e.g., 30 to 90 days) may elapse between the date that a large claim payment is made by ICI Mutual to an insured and the date that ICI Mutual receives the corresponding reimbursements that are due to ICI Mutual from its independent third-party reinsurers.

<sup>10</sup> In most cases, the "timing" issue discussed in note 9 above is not problematic for ICI Mutual because it is relatively uncommon for ICI Mutual to be required to make single-date payments in amounts large enough to necessitate the liquidation of a significant portion of ICI Mutual's investment portfolio. Even in the case of a large, single-date payment, ICI Mutual would have the ability to fund an insurance claim payment by selling portfolio securities and then subsequently repurchasing those securities following receipt of reinsurance reimbursement. However, such a course of action could present certain financial issues for ICI Mutual, which, while not easily quantifiable, could be costly and disruptive, depending upon the particular circumstances involved. These issues include: (1) having to sell portfolio securities in a down market; (2) the potential tax consequences for ICI Mutual of realizing gains or losses; and (3) the overall disruption to ICI Mutual's management of its investment portfolio. Bank membership is designed to assist ICI Mutual in mitigating these financial issues.

<sup>11</sup> 79 Fed. Reg. 54848, at 54854. More specifically, the Proposed Rule notes that in the case of a "small but growing number of captives [that] have become Bank members ... in some cases the primary, or sole, motivation for those captives being created has been to become members in order to serve as a funding conduit through which a parent or affiliate of the captive, which is not itself eligible for Bank membership, may gain access to Bank advances." The Proposed Rule explains that "[t]hose captives have been able to become members because the existing regulation does not prohibit it and does not otherwise distinguish between

“pure” (i.e., single parent) captive insurance companies, including those established as subsidiaries of real estate investment trusts (“REITs”), which captives have reportedly in some cases “obtained advances in dollar amounts so large that they appear to have no relationship to the operations of the captive and appear to flow to the REITs.”<sup>12</sup> The Proposed Rule explains that these REITs have “through the use of captives ... been able to borrow indirectly from the Banks—something the statute precludes them from doing directly.” The Proposed Rule states that its provisions are “intended to prevent these arrangements ....”<sup>13</sup>

ICI Mutual is not the type of “captive” insurance company at which the Captive Prohibition is directed. Rather, as a risk retention group providing liability insurance to businesses within the American mutual fund industry, ICI Mutual is functionally equivalent to the “traditional insurance companies” which the Proposed Rule recognizes to be eligible for Bank membership. As discussed in Section A above, ICI Mutual has no parent company, nor does it have any other owners apart from its insured fund groups. Any advances that ICI Mutual may obtain from the Bank will not “flow to” or be “borrowed,” directly or indirectly, by any of these member fund groups; rather, as detailed above, any such advances will provide a source of temporary liquidity for ICI Mutual’s *own* operational needs as an insurance company. Moreover, ICI Mutual does not present any of the “safety and soundness concerns” referenced in the Proposed Rule.<sup>14</sup>

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insurance companies that become members to support their own operations and those that become members with the intention of obtaining advances to finance the business operations of a parent or affiliate.”

<sup>12</sup> Id.

<sup>13</sup> Id.

<sup>14</sup> The Proposed Rule (79 Fed. Reg. 54848, at 54854) lists the following “safety and soundness concerns” that the FHFA believes to be presented by captives, none of which apply to ICI Mutual:

- **“Relative unavailability of objective financial information and ratings as compared to other insurers and depository institutions”:** ICI Mutual prepares a full set of statutory and GAAP financial statements. The statutory statements are in full compliance with the rules promulgated by the National Association of Insurance Commissioners (“NAIC”) for all insurance companies, and are quite extensive. ICI Mutual’s GAAP financial statements are audited by PricewaterhouseCoopers and are fully compliant with generally accepted accounting principles required of property and casualty insurers. In addition, the Company has been rated “A” (Excellent) by A.M. Best Company, a nationally recognized statistical rating organization, since 1993, the first year that ICI Mutual was eligible to receive a rating.
- **“The financial condition of the captive, which operates to serve the parent, rather than in its own financial self-interest, may deteriorate rapidly due to the actions of the parent”:** As a risk retention group, ICI Mutual does not have a parent. ICI Mutual is owned by its many insured fund groups, all of whom have a voting interest of under five percent.
- **“The parent may decline to provide financial support, or to provide additional collateral, in cases of financial distress”:** Again, ICI Mutual does not have a parent, and consequently is not beholden to a parent for financial support. ICI Mutual carries surplus to support its operations in amounts far in excess of those typically required. This prudent management has been recognized by A.M. Best, which, as noted above, has continuously rated the Company “A” (Excellent) since 1993, the first year that ICI Mutual was eligible for a rating.

**2. *Under the Proposed Rule, ICI Mutual may nevertheless be at risk of being deemed a “captive insurance company” so as to be subject to the Captive Prohibition.***

The Proposed Rule defines the term “captive” to mean “a company that is authorized under state law to conduct an insurance business, but that does not meet the definition of ‘insurance company’ set forth in the Proposed Rule ....” The term “insurance company,” in turn, is defined to mean “a company whose primary business is the underwriting of insurance for nonaffiliated persons or entities.” It follows that any company that is authorized under state law to conduct an insurance business, but whose primary business is the underwriting of insurance for “affiliated” persons or entities, would *not* meet the definition of “insurance company,” and would thus be deemed a “captive.”

The Proposed Rule does not define the term “affiliate.” As a result, ICI Mutual may be at risk of being deemed a “captive,” depending on how the term “affiliate” is construed. As discussed in Part A, ICI Mutual operates as a risk retention group under the LRRRA, and as such, “has as its owners only persons who comprise the membership” of ICI Mutual “and who are provided insurance” by ICI Mutual. If insured fund groups are deemed to be “affiliates” of ICI Mutual solely by reason of such “ownership,” then ICI Mutual could presumably be deemed to be a “captive” subject to the Captive Prohibition.

**3. *ICI Mutual urges the FHFA to consider certain technical revisions to the Proposed Rule in order to ensure that ICI Mutual and any similarly-situated insurance companies may remain Bank members.***

As stated in the introduction to this letter, ICI Mutual takes no position as to the advisability of the FHFA adopting the Proposed Rule, or as to the advisability of the FHFA adopting the Captive Prohibition as a provision therein. However, if the FHFA does decide to proceed with the Proposed Rule and the Captive Prohibition, ICI Mutual would urge the FHFA to consider the following technical revisions to the Proposed Rule in order to ensure that ICI Mutual and any similarly-situated insurance companies may remain Bank members:

- **Define the term “affiliate”:** ICI Mutual suggests that the FHFA define the term “affiliate” so as to clarify that the Captive Prohibition would not extend to risk retention groups, such as ICI Mutual, with diffuse, widely-held ownership. This could be
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- ***“The captive’s balance sheet may reflect non-diversified risk if its underwriting activities are narrowly prescribed by the parent”:*** ICI Mutual has no parent which can “narrowly prescribe” its underwriting activities. As discussed in Part A, ICI Mutual provides insurance products to approximately 120 member fund groups, ranging from some of the smallest to some of the largest fund groups in the mutual fund industry. In addition, ICI Mutual utilizes over two dozen financially sound and highly-rated independent, third-party reinsurers to further diversify the insurance risks it assumes.

accomplished through the adoption of a definition similar to that set forth in the Bank Holding Company Act (“BHCA”), which defines an “affiliate” to mean “any company that controls, is controlled by, or is under common control with another company.” See 12 U.S.C. § 1841(k). As in the BHCA, the term “control,” in turn, could be defined broadly. See 12 U.S.C. § 1841(a)(2).<sup>15</sup> The concerns raised by ICI Mutual, as expressed above, could be addressed through the inclusion of a provision, as in the BHCA, establishing a “presumption that any company which directly or indirectly owns, controls, or has power to vote less than 5 per centum of any class of voting securities of a given ... company does not have control over that ... company.” See 12 U.S.C. § 1841(a)(3). Such a definition would likewise accord with other regulatory definitions of “affiliate.”<sup>16</sup>

- **Revise the “sunset” provision:** The Proposed Rule would permit any “captive” admitted to Bank membership prior to the publication date of the proposed rule to remain a Bank member for five years following the effective date of the final rule, subject to certain restrictions on advances. In lieu of, or in addition to, defining the term “affiliate,” ICI Mutual suggests that this “sunset” provision could be revised. More specifically, ICI Mutual suggests that a “captive” insurance company meeting the following criteria be “grandfathered” under the final rule so as to permit the captive to retain its Bank membership and full membership rights: (1) the captive does not have a parent company, (2) the captive has been lawfully admitted to Bank membership prior to the publication date of the Proposed Rule, and (3) the captive remains an existing Bank member in good standing as of the effective date of the final rule.

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We remain concerned that the Proposed Rule, in its current form, could create uncertainty as to ICI Mutual’s ability to continue its Bank membership in the years to come. Maintaining Bank membership is highly important to ICI Mutual, as reliable access to Bank advances provides increased assurance that ICI Mutual will be in a position, when the occasion may demand, to satisfy its operational obligations to fund large claim payments without undue disruption to its investment portfolio. Maintaining Bank membership will thus (1) promote ICI Mutual’s broader mission of providing a stable, reliable, long-term source for certain specialized liability insurance products required by fund groups within the American mutual fund industry,

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<sup>15</sup> Section 1841(a)(2) of the BHCA provides that a “company has control over a bank or over any company if (A) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company; (B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or (C) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.”

<sup>16</sup> See, e.g., Section 221a of the Federal Reserve Act and Section 2(a) of the Investment Company Act of 1940.



and (2) permit ICI Mutual to commit a significant portion of its investment portfolio to residential mortgage-backed securities, thereby aligning it with the mission of the FHFA.

We respectfully suggest that modest revisions to the Proposed Rule, as described above, would address the concerns we have raised. These modest revisions would neither impede nor otherwise interfere with the FHFA's ability to address and resolve the supervisory concerns set forth in the Proposed Rule regarding "institutions that are ineligible for Bank membership, but that are using captives as vehicles through which they can obtain Bank advances to fund their business operations."<sup>17</sup>

We appreciate the opportunity to provide the foregoing comments.

Sincerely yours,



Daniel T. Steiner

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<sup>17</sup> 79 Fed. Reg. 54848, at 54853.