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4 December 2012

Via email to RegComments@fhfa.gov

Alfred M. Pollard, General Counsel,
Attention: Comments/2012–N–14,
Federal Housing Finance Agency
400 7th Street SW - Eighth Floor
Washington, DC 20024

RE: FHFA Advisory Bulletin on Collateralization of Advances and Other Credit Products Provided by Federal Home Loan Banks to Insurance Company Members [No. 2012–N–14]

Dear General Counsel Pollard:

The American Council of Life Insurers is grateful for the opportunity to comment upon the captioned, proposed advisory bulletin. The ACLI respects the FHFA's appreciation of the challenges of working within multiple statutory and regulatory insurance regimes, and understanding how institutional interests may be affected by variations among those regimes. ACLI member companies confront these challenges routinely. The fact that "there is little precedent to indicate how the insurance commissioner in any given state would deal with repayment of the member's outstanding advances or with the Bank's security interest in advances collateral in the event of a failure of an insurance company member"[i] indicates that insurers and the Federal Home Loan Banks (FHLBs) succeed in dealing with the challenges routinely. While numerous factors contribute to the insurance companies' resiliency as members of FHLBs, we use this opportunity to highlight four in particular: the use of Statutory Accounting Principles; collateralization of FHLB advances by their insurance company members; use of funding agreements in FHLB advances with insurance companies; and collaboration with FHLBs on new legislative initiatives.

Statutory Accounting Principles

It is encouraging that the FHFA recognizes that the financial statements of insurance companies are based upon statutory accounting principles (SAP) rather than generally accepted accounting principles (GAAP), on which the financials of all federally insured depository institutions are based. As the proposed Bulletin details:

> SAP generally reflects a liquidating rather than going concern basis of accounting. For example, SAP requires that deferred policy acquisition costs be expensed immediately instead of matched against the premiums as they are earned and recognized in income. Accordingly, performance measures calculated using SAP numbers typically appear *less* favorable than those prepared using GAAP numbers.[ii]

Insurance accounting is more conservative than bank accounting, improves the transparency of the value of insurer collateral pledged in respect of advances provided by the FHLBs, and ultimately conveys an accurate rendition of the strength of insurance company members of the Home Loan Banks.

Perfected Security Interests in Insurance Company Collateral

The FHFA proposal appeals for an appropriate method for the FHLBs to obtain ''control'' of securities pledged as collateral and to otherwise obtain a perfected first priority security interest under the Uniform Commercial Code in all such collateral pledged by its insurance company members.[iii] There is no empirical basis for modifying legislation in order to achieve a higher level of perfection than already exists today. The FHLBs have mitigated the different risks associated with each membership group through prudent secured lending practices. All advances to insurance companies are fully-secured and managed to a zero-loss expectation by the FHLBs. Insurance company advances are primarily collateralized by high credit quality securities of commercial loans or CMBS of higher quality with readily available market prices. Both of these types of collateral are highly liquid and could be readily sold, or securitized quickly. Moreover, all collateral pledged by insurers to the FHLB is physically held by the FHLBs, creating a perfected first-priority security interest in the collateral.

The FHLBs have never taken a loss on an advance in their 80-year history. During that time, the FHLBs effectively collaborated with state insurance regulators to manage three member rehabilitations without taking a loss on an advance.[iv] The FHLBs have been successfully lending to insurance companies on a more conservative, fully-secured basis, consistent with the FHLB Act since the System's creation in 1932.

Funding Agreements

Funding agreements are insurance products guaranteed by the issuing insurance company's general account. Prior to issuing any funding agreements, an insurance company must file a funding agreement policy form with the applicable state insurance department. The funding agreements are then subject to the strict scrutiny and risk management practices of the insurance commissioners that regulate these contracts.

In certain states, state law explicitly provides that funding agreements rank *pari passu* with the claims of policyholders.[v] In other states, an insurance company may obtain an opinion from counsel that state law supports the conclusion that funding agreements are insurance contracts or policies and, therefore, rank *pari passu* with the claims of policyholders. Hence, both life insurance policy claims and funding agreement claims are assigned the same level of priority in the event that the issuing insurer is subject to rehabilitation, liquidation, conservation or dissolution. Additionally, to assure the highest degree of confidence for the FHLBs, the insurer must fully secure the transaction based on the applicable FHLB credit policies for advance products when a FHLB executes a funding agreement with an insurance company.

New Initiatives to Improve Federal Confidence in Insurance Company Collateral

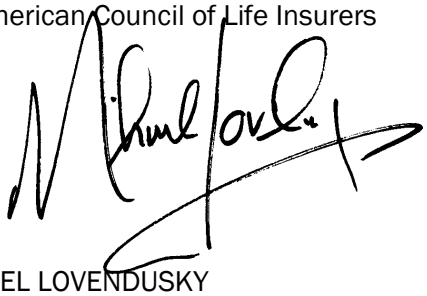
Both the Banks and the ACLI are confident that the traditional considerations of insurance company membership in the System should satisfy regulatory concerns. Nevertheless, the Banks and the ACLI are collaborating on additional ways to address FHFA concerns with regard to the issues raised in the proposed Bulletin. In October 2012, the ACLI agreed to a proposal from FHLB-Pittsburgh to advocate changes in state receivership laws.[vi] The goal of this initiative is to provide the FHLBs with greater flexibility to avoid a stay in the event of an insurer's insolvency and to exercise its rights to immediately liquidate collateral pledged by an insurance company.

Conclusion

A one-size-fits-all approach for lending would reduce the effectiveness of each FHLB's monitoring efforts of its members and the unique characteristics of their membership regions. Insurance companies have contributed to the soundness and success of the FHLB system in part because of the protections outlined above. The ACLI believes insurers should continue to participate fully as members of the FHLBs for all of the intended purposes of the FHLB system.

Sincerely,

The American Council of Life Insurers



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[i] Proposed Advisory Bulletin, 77 Federal Register 60989, October 5, 2012, paragraph III.

[ii] Proposed Advisory Bulletin, 77 Federal Register 60992, October 5, 2012 (italics added).

[iii] At 77 Federal Register 60989, October 5, 2012, paragraph III.

[iv] Old Standard Life (2004); Standard Life of Indiana (2008); and Shenandoah Life (2008).

[v] For example, funding agreements are addressed in the New York Insurance Law at N.Y. Ins. Law § 3222, which provides, in pertinent part, as follows:

> Funding agreements. (a) Any insurer authorized to deliver or issue for delivery annuity contracts in the state may deliver or issue for delivery one or more funding agreements. The issuance or delivery of such funding agreements shall not be deemed to be doing a kind of business specifically authorized by section one thousand one hundred thirteen of this chapter or engaging in any business authorized by section one thousand seven hundred fourteen of this chapter. Notwithstanding the definition of "insurance contract" in paragraph one of subsection (a) of section one thousand one hundred one of this chapter, the issuance or delivery of a funding agreement by an insurer in this state shall constitute doing an insurance business herein.

As a general matter, the issuance of funding agreements is considered to constitute the "doing of an insurance business", which supports the view that funding agreements should warrant the same treatment as other types of insurance contracts. In the event that a life insurer is subject to an order of rehabilitation, liquidation, conservation or dissolution, claimants under insurance policies and funding agreements are accorded equal priority. Section 7435 of the New York Insurance Law provides, in pertinent part, as follows:

> Distribution for life insurers. (a) The priority of distribution of claims from the estate of a life insurance company in any proceeding subject to this article shall be in accordance with the order in which each class

> of claims is herein set forth. Every claim in each class shall, subject to such limitations as may be prescribed by law and do not directly conflict with the express provisions of this section, be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be: …
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> (4) Class four. All claims under insurance policies, annuity contracts and funding agreements, and all claims of The Life Insurance Company Guaranty Corporation of New York or any other guaranty corporation or association of this state or another jurisdiction, other than (i) claims provided for in paragraph one of this subsection, and (ii) claims for interest. …
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> (b) Every claim under a separate account agreement providing, in effect, that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurer shall be satisfied out of the assets in the separate account equal to the reserves maintained in such account for such agreement and, to the extent, if any, not fully discharged thereby, shall be treated as a class four claim against the estate of the life insurance company.

[vi] ACLI understands that almost all of the Banks have agreed to advocate the same proposal endorsed by the ACLI. This legislative proposal differs from the change in Michigan law legislated in 2012 which achieves the same result sought by the FHLBs and the FHFA but in a manner less agreeable to insurance companies and insurance regulators.