The Debrief

Federal Reserve Previews New Insurance Holding Company Capital Requirements

January 17, 2019

On January 9, 2019, Federal Reserve Board ("FRB") Vice Chairman for Supervision Randal Quarles gave an important speech previewing the next step in the FRB's multiyear effort to develop capital standards for depository institution holding companies significantly engaged in insurance activities ("insurance holding companies"). This effort flows from the Dodd-Frank Act, which gave the FRB regulatory responsibility for insurance holding companies that own full-service, federally insured depository institutions.

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The development of capital standards for insurance holding companies will be a post-Dodd-Frank Act milestone for the FRB. Indeed, once the FRB applies capital standards to insurance holding companies, the FRB may consider how its supervisory stress requirements and other capital-related enhanced prudential standards should apply to these firms.

Vice Chairman Quarles provided details on the building block approach ("BBA")for insurance holding company capital requirements, which the FRB previewed in a 2016 advance notice of proposed rulemaking (see our prior analysis on the advance notice of proposed rulemaking).[1] The Vice Chairman indicated the FRB expects to publish a formal proposal "in the not-too-distant future" that will be intended to "capture all material risk" of insurance holding companies, "leverage existing legal-entity standards, and minimize burden."

Key points from Vice Chairman Quarles' speech are as follows:

- Under the BBA, an insurance holding company's entities would be grouped into building blocks based on the capital regime to which the entities are subject. The capital resources and requirements of each block would be computed using the capital requirements applicable to the entities within a block. For example, life insurance capital requirements would apply to life insurance subsidiaries within a life

[1] The FRB's prior advanced notice of proposed rulemaking also discussed potential capital requirements for insurance holding companies that have been designated for FRB supervision by the Financial Stability Oversight Council. Vice Chairman Quarles' speech does not address this category. At present, there are no such designated insurance holding companies.

insurance block. Similarly, in a depository institution building block, subsidiaries within the block would be subject to bank regulatory capital requirements. The BBA generally would apply bank capital rules to nonbank/noninsurance building blocks in order "[t]o address regulatory gaps and arbitrage risks, like those made manifest in the financial crisis."

- Once the capital resources and requirements are computed for each building block, certain adjustments would be made to the building blocks before aggregating the capital positions of each block. The adjustments would be intended to enable to the BBA's aggregation to function appropriately and also to reflect the FRB's supervisory objectives. For example, the BBA would apply insurance capital rules consistently, without regard to permitted accounting practices granted by an individual state, thus uniformly applying statutory accounting principles as set forth by the National Association of Insurance Commissioners ("NAIC"). Similarly, at the insurance holding company level, adjustments may be needed to allow only instruments that meet criteria under the FRB's capital rules to qualify as capital for the holding company.

- Next, because each capital regime has a different scale for its ratios and thresholds, capital positions in different regimes would be scaled and equated through analyzing historical defaults under those regimes.

- Once the insurance holding company's aggregate capital position is calculated, the "BBA would impose a minimum requirement that is calibrated to be consistent with the [FRB's] role to ensure that the risks of the enterprise do not present undue risk to the safety and soundness of the depository institution."

- Vice Chairman Quarles described the FRB's ongoing coordination with the NAIC and recognized that some differences between the FRB's BBA and the NAIC's Group Capital Calculation ("GCC") may arise. Noting that the NAIC plans to conduct a field test of the GCC this spring, Vice Chairman Quarles indicated that the FRB plans to take a similar step and conduct a quantitative impact study of the BBA as part of the rulemaking process.

We will continue to monitor and provide further updates of the FRB's efforts in this space.

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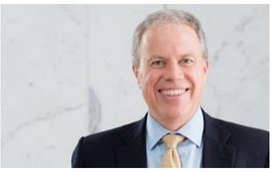

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