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FRB Request for Comment on Proposed Framework for the Supervision of Insurers With Full-Service Banks or Thrifts

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On January 28, 2022, the Board of Governors of the Federal Reserve (the "FRB") released for comment proposed guidance (the "Proposed Guidance") to implement a framework (the "Proposed Framework") for the supervision of certain insurance companies that also have a full-service bank or thrift within their consolidated enterprise.[1] The Proposed Guidance incorporates the capital framework previously proposed in the FRB's 2019 Notice of Proposed Rulemaking on regulatory capital rules applicable to such insurance companies.[2]

The FRB describes the Proposed Framework as a "significant step" in the ongoing development of the FRB's tailored approach to supervision and regulation of both bank holding companies and savings and loan holding companies (together, "Depository Institution Holding Companies") significantly engaged in insurance activities.[3] The Proposed Guidance would apply to any Depository Institution Holding Company that (i) is itself an insurance underwriting company (*i.e.*, the insurer indirectly or directly owns the bank or thrift) or (ii) has 25 percent or more of its consolidated assets held by insurance underwriting subsidiaries (a "Supervised Insurance Organization"). Additionally, Depository Institution Holding Companies that do not meet the above criteria with insurance underwriting companies may be designated as Supervised Insurance Organizations if FRB staff decides that such a classification would result in more effective supervision as a result of their assessment of such an organization's risk profile.

The Proposed Framework would apply supervisory guidance and assign supervisory resources based on the complexity and risk profile of a Supervised Insurance Organization. The Proposed Framework also would formalize a supervisory rating

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1 FRB, Press Release, Federal Reserve Board invites public comment on proposed guidance to implement a framework for the supervision of certain insurance organizations overseen by the Board (Jan. 28, 2022, 2:30 p.m. EST), *available* here; 87 FR 6537 (Feb. 4, 2022), *available* here.

2 Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 FR 57240 (Oct. 24, 2019).

3 FRB, Board of Governors of the Federal Reserve System Memo (Jan. 12, 2022), *available* here.

system for these organizations and describe how FRB examiners would work with relevant supervisors and regulators.

This client update provides background on the FRB's supervision of Depository Institution Holding Companies significantly engaged in insurance activities as well as an overview of the three key components of the Proposed Framework.

I. Background

The FRB regulates and examines on a consolidated basis all Depository Institution Holding Companies, including currently a portfolio of savings and loan holding companies significantly engaged in insurance activities. Given that the overwhelming majority of Depository Institution Holding Companies do not have a significant insurance underwriting company within their consolidated enterprise, the oversight practices of the FRB are oriented towards holding companies, the primary risks of which are related to the business of banking.

However, the FRB recognizes in the Proposed Guidance that the risks arising from Depository Institution Holding Companies, including significant insurance activities, can be materially different than those arising from banking activities. For example, the Proposed Guidance notes that Depository Institution Holding Companies for which the top-tier holding company is an insurance underwriting company are subject to supervision and regulation by applicable state insurance regulators as well as consolidated supervision from the FRB, with state insurance regulators responsible for the supervision and regulation of all such organizations' insurance underwriting business.

The FRB already has taken some steps to differentiate its supervision and regulation of Supervised Insurance Organizations. For example, in 2018, the FRB did not apply the supervisory rating systems applicable to banking Depository Institution Holding Companies to Supervised Insurance Organizations.[4] More recently, in 2019, the FRB invited comment on a proposal to establish a risk-based capital framework, termed the "Building Block Approach," designed specifically to adjust and aggregate the existing legal entity capital requirements into a consolidated capital framework for Supervised

[4] *See* Large Financial Institution Rating System; Regulations K and LL, 83 FR 58724 (Nov. 21, 2018); Application of the RFI/C(D) Rating System to Savings and Loan Holding Companies, 83 FR 56081 (Nov. 9, 2018).

Insurance Organizations to determine an appropriate enterprise-wide capital requirement.[5]

The Proposed Framework represents a continuation and greater formalization of the FRB's tailored approach to supervision and regulation of Depository Institution Holding Companies significantly engaged in insurance activities.

II. The Proposed Framework

As noted above, the Proposed Framework is designed to recognize the unique risks and business profiles of Supervised Insurance Organizations resulting primarily from such organizations' insurance business. As such, the Proposed Guidance outlines three principles specifically tailored for Supervised Insurance Organizations: (i) a risk-based proportional approach establishing supervisory expectations, assigning supervisory resources and conducting supervisory activities; (ii) the creation of a distinct supervisory rating system; and (iii) a description of how FRB examiners would rely on and work with applicable regulators and supervisors to limit the burden associated with supervisory duplication.

A. Proportionality of FRB Supervisory Activities and Expectations

The FRB's application of supervisory guidance as well as assignment of supervisory resources would be proportional to the risks posed by each Supervised Insurance Organization. In order to accomplish this objective, FRB staff first would separate Supervised Insurance Organizations into either a "complex" or "noncomplex" category based on each Supervised Insurance Organization's risk profile.

Whether a Supervised Insurance Organization is classified as complex or noncomplex is based on the FRB's consideration of a number of factors, including: quality and level of capital and liquidity, the size of its depository institution(s), organizational structure, unregulated and/or unsupervised activities, international exposure, product and portfolio risks, supervisory ratings and opinions and interconnectedness. Moreover, regardless of any other factor, any Supervised Insurance Organization with a bank or thrift with more than $100 billion in assets would be classified as complex. For clarity, however, the FRB could apply the above factors and deem a Supervisory Insurance

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5 Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 FR 57240 (Oct. 24, 2019).

Organization with more than $100 billion in total consolidated assets (but with a bank or thrift with assets below $100 billion) as noncomplex.[6]

The characterization by the FRB of a Supervised Insurance Organization as complex or noncomplex would have a significant impact on the organization's frequency and level of FRB oversight and examination:

- **Complex Supervised Insurance Organization**. The FRB believes complex organizations have a higher level of risk and thus require more frequent and intense supervisory attention. Complex Supervised Insurance Organizations would be assigned a dedicated team of examiners responsible for consolidated supervision of the organization. These organizations would be subject to routine continuous monitoring and targeted examinations as necessary to properly understand and assess the organization. These Supervised Insurance Organizations also would be subject to continuous monitoring and targeted examinations as the FRB deems necessary.

- **Noncomplex Supervised Insurance Organization**. The FRB believes noncomplex Supervised Insurance Organizations have a lower risk profile and thus require less frequent or intense supervisory oversight. Under the Proposed Framework, these organizations would only be subject to annual FRB examinations. The Proposed Framework also suggests that these institutions would not have resident FRB examiners.

The FRB would reassess each Supervised Insurance Organization's categorization as complex or noncomplex on an annual basis. Depending on the result of such risk profile reassessments, FRB examiners would inform the organization as to whether its categorization had changed, which would then affect the frequency and severity of the examiners' oversight.

B. Supervisory Ratings

The Proposed Framework would replace the FRB's RFI/C(D) holding company ratings framework with a new ratings framework applicable to Supervised Insurance Organizations, and ratings would be given on an annual basis based on three components: Governance and Controls; Capital Management; and Liquidity Management. As to the ratings themselves, the Proposed Framework sets forth four levels of ratings, from least to most problematic—Broadly Meets Expectations,

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6 The FRB notes that an organization could be classified as noncomplex if most of the organization's assets were a result of traditional insurance activities and if the organization had a small depository institution, a history of maintaining relatively large capital and liquidity buffers and was considered relatively well-run with little risk to the organization's depository institution.

Conditionally Meets Expectations, Deficient-1 and Deficient-2—with particular consideration placed on the obligations that such organizations have as sources of financial and managerial strength for their depository institution(s). A description of the three components on which ratings are given is provided below:

- **Governance and Controls**. The Governance and Controls component rating would be derived from an assessment of the effectiveness of a Supervised Insurance Organization's board and senior management, as well as independent risk management and controls. To assess a Supervised Insurance Organization's Governance and Controls component, FRB examiners would consider an organization's risk management capabilities relative to its risk exposure within the following areas: internal audit; credit risk; legal and compliance risk; market risk; model risk and operational risk, including cybersecurity/information technology; and third-party risk. The FRB expects Supervised Insurance Organizations to put in place risk management and control frameworks that are commensurate with the organization's structure, risk profile, complexity, activities and size; the FRB notes, for example, that while a chief risk officer is not required under the Proposed Framework, most large insurance companies have an independent chief risk officer.

- **Capital Management**. Under the Proposed Framework, the FRB Capital Management component rating would be derived from an assessment of an organization's current and stressed level of capitalization and the quality of its capital planning and stress testing. In the Proposed Guidance, the FRB recognizes that insurance company balance sheets are typically quite different from those of most banking organizations. Accordingly, the FRB notes in the Proposed Guidance that it relies to the fullest extent possible on information provided by the state insurance regulators, including the insurance organization's Own Risk and Solvency Assessment report ("ORSA") and the state insurance regulator's written assessment of the organization's ORSA.

- **Liquidity Management**. A Supervised Insurance Organization's Liquidity Management component rating would be derived from FRB examiners' assessment of the Supervised Insurance Organization's liquidity position as well as the quality of its liquidity risk management program, the latter of which should be commensurate with the organization's complexity and risk profile. The FRB acknowledges that insurance companies are typically less exposed to liquidity risks than are banks; as such, the FRB's expectations for Supervised Insurance Organizations reflect this difference while still expecting that all Depository Institution Holding Companies still adhere to basic established principles related to the management of liquidity risk.

Modeled after the Large Financial Institution ("LFI") rating system previously introduced by the FRB in 2019, Supervised Insurance Organization would be assigned one of the above-listed four ratings for each of the three components. However, the Proposed Framework modifies the LFI rating system so that the Proposed Framework's rating system is specifically tailored to Supervised Insurance Organizations of all sizes as well as risk profiles. FRB examiners would evaluate each Supervised Insurance Organization's practices in light of its risk profile, assigning it a rating based on the examiners' evaluation of each of the three components. To be considered "well managed," a Supervised Insurance Organization must receive a rating of at least Conditionally Meets Expectations in each of the three rating components. The ratings assigned across each of the three components to any Supervised Insurance Organization can result in variations in applicable guidance across organizations. A Supervised Insurance Organization in receipt of a Deficient-1 or Deficient-2 rating would be presumed to be subject to a formal enforcement action and may also be restricted from engaging in new activities or acquisitions.

C. Incorporating the Work of Other Supervisors

Under the Proposed Framework, FRB examiners would cooperate with state insurance and other relevant regulators in order to share information and coordinate activities to limit duplication of effort or undue burden while still carrying out each supervisory regulator's responsibilities effectively. In accordance with the Bank Holding Company Act, the Proposed Framework states that the FRB must use, to the fullest extent possible, reports required to be provided by a bank holding company or its subsidiary to regulatory agencies, information requested by such regulatory agencies or to be otherwise reported publicly and externally audited financial statements of the bank holding company or subsidiary.[7] FRB examiners would rely to the fullest extent possible and consistent with statutory requirements on information gathered as well as assessments developed by other relevant supervisors and regulators, in particular leveraging work done by state insurance supervisors in their own supervisory efforts.

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Comments will be accepted until April 5, 2022.

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7 12 U.S.C. § 1844(c)(1)(B).

NEW YORK

Eric R. Dinallo
edinallo@debevoise.com

Gregory J. Lyons
gjlyons@debevoise.com

Alison M. Hashmall
ahashmall@debevoise.com

Caroline Novogrod Swett
cnswett@debevoise.com

Nariné A. Atamian
naatamian@debevoise.com

Courtney Bradford Pike
cbpike@debevoise.com

WASHINGTON D.C.

Satish M. Kini
smkini@debevoise.com