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News & Updates

FEDERAL RESERVE TAKES STEPS ON CAPITAL STANDARDS FOR NONBANK SIFIS

The passage of the Dodd-Frank Act led to an increased role for federal financial regulators in regulating insurance companies. While insurance companies are still primarily regulated at the state level, certain insurance companies also qualify for federal regulation. For example, Dodd-Frank explicitly requires that the Federal Reserve Board (FRB) regulate all financial institutions designated as systemically important financial institutions (nonbank SIFIs) by the Financial Stability Oversight Council (FSOC). Currently, FSOC has designated two insurance companies as nonbank SIFIs: Prudential and AIG. The FSOC also designated MetLife as a nonbank SIFI, but a U.S. district court judge recently overturned that designation.

While the FRB has extensive experience regulating banks, it has relatively little experience regulating insurance companies. One open question is how the FRB will choose to regulate insurance companies given that they are very different entities than banks, operating on very different business models. The industry now has its first glance at how the FRB might approach this.

At its June 3 open board meeting, the FRB approved an Advance Notice of Proposed Rulemaking (ANPR) seeking public comment on two different frameworks for applying capital standards to insurance companies. Under the first framework, also called the “consolidated approach,” the FRB “would categorize an entire insurance firm’s assets and insurance liabilities into risk segments, apply appropriate risk factors to each segment at the consolidated level, and then set a minimum ratio of required capital.” This approach would apply to any insurance company designated as a nonbank SIFI.

Under the second framework, also called the “building block approach,” the FRB “would aggregate existing capital requirements across a firm’s different legal entities to arrive at a combined, group-level capital requirement, subject to adjustments to reflect the Board’s supervisory objectives.” This approach would apply to any insurance company that owns a bank or a thrift.

Notably, the FRB is choosing to use an ANPR instead of offering a proposed rule right out of the gate. An ANPR is a tool employed by federal agencies to invite public comment while the agency is still in the beginning stages of the rulemaking process. This gives parties an opportunity to help shape the rule rather than just respond to a proposed rule that may be closer to final form. In this case, this approach permits the FRB to have conversations with industry and other interested persons and groups, including the NAIC, much earlier in the process and creates the potential for a much better rule. Clearly, the FRB is sensitive to its role as the “new kid on the block” in this area and has emphasized that the goal of both approaches is to take into account the differences between insurance companies and banks.

At the same meeting, the FRB also approved a proposed rule that would apply “enhanced prudential standards” to insurance companies designated nonbank SIFIs. This rule implements standards, required under Dodd-Frank, that the FRB “apply consistent liquidity, corporate governance, and risk-management standards” to the companies. In addition, the proposed rule would also require each insurance nonbank SIFI to employ a chief actuary and a chief risk officer as additional safeguards to possible collapse.

All comments to both the ANPR and the Proposed Rule are due to the FRB by August 2, 2016.

If you have any questions on how this could impact your business, please contact:

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