Federal Reserve Previews "Building Block Approach" to Insurer Capital Standards

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Despite the few number of insurers regulated by the Federal Reserve Board (the Fed), all insurers should take note of Board Vice Chair Randal K. Quarles's [1] speech to the American Council of Life Insurers (ACLI) last week. On January 9, 2019, Mr. Quarles "previewed" the Fed's plans to propose group capital standards for the insurers it regulates. Mr. Quarles noted that the Fed's standards will be unique and, while they will build on current US insurance capital standards for insurance operations within the group, they will not be identical to any existing capital standards or to other pending capital standards proposals.[2]

Federal Reserve to Announce Building Block Approach for Insurer Capital Standards

Mr. Quarles informed the ACLI that announcement of a Federal Reserve capital standard regime is forthcoming "in the not-too-distant future," and that it will reflect a "Building Block Approach" (BBA). He noted that the Fed's goal has been to develop a consolidated capital requirement based on policies that are insurance-centric and appropriate for insurance risks. The Fed believes that an aggregation-based approach, like the BBA, could also strike a better balance between entity-level and enterprise-wide supervision of insurance firms. The new BBA standards will be unlike the Fed's standards for Bank Holding Companies and will build on the regulatory capital rules of functional regulators governing insurers' insurance and banking subsidiaries.

The Fed's goal is a capital framework that encompasses all material risks across the entire supervised enterprise, one that promotes transparency and comparability across firms. The Fed envisions a BBA that relies on existing US accounting and capital frameworks to the greatest extent possible, including the NAIC's insurance risk-based capital framework.

BBA Preview

According to Mr. Quarles, the Fed intends to propose a capital-requirement standard based on groupings – or "building blocks" – of entities within the regulated holding company that are covered under the same capital regime. These building blocks will then be aggregated to calculate combined, enterprise-level capital resources and requirements. In each building block, the BBA generally applies the capital regime already applicable to the subsidiaries in that block. For example, a life insurance building block will be subject to US insurance capital standards, while a depository institution building block will be subject to its functional regulator's capital standards. Mr. Quarles also noted that the BBA generally would apply bank regulatory capital requirements to nonbank/non-insurance building blocks, such as derivatives activity.

Mr. Quarles also noted the importance of standardization and comparability, and previewed some anticipated adjustments to be made in the aggregation:

- Disregarding internal capital models
- Excluding state insurance department accounting permitted practices
- Accounting for intercompany transactions

He also stated that the Fed plans to conduct a "quantitative impact study" of its BBA approach and hopes that regulated firms will provide information and feedback.

Fed Relationships with Other Insurance Regulators

While Mr. Quarles noted that the Fed is part of insurance regulatory "Team USA," which consists of the Federal Reserve, the NAIC and the Federal Insurance Office, the BBA will differ in some ways from the NAIC Group Capital Calculation. Specifically, Mr. Quarles observed that the Fed's mandate on protection of federally insured depository institutions requires a focus on "safety-and-soundness objectives," while state insurance regulators focus on "policyholder protection." However, Mr. Quarles emphasized that the Fed has "engaged in dialogue" with the NAIC and has joined the IAIS to advocate for regulatory approaches that reflect the accounting and capital standards in the US, the world's largest insurance market.

1 Mr. Quarles is the Federal Reserve Board's Vice Chair for Supervision and International Engagement.

2 According to Mr. Quarles, the Fed will not adopt European Solvency II, IAIS Insurance Capital Standards or NAIC Group Capital Calculation, for various stated reasons.

Mr. Quarles also indicated that the Fed will advocate for a Team USA approach at IAIS, creating further distance from an equivalency determination any time soon. We will continue to follow developments on these issues.

For additional information, visit:

- NAIC Group Capital Standards
- IAIS July 31, 2018 ICS Consultation Document
- 2018 FIO Report on the Insurance Industry
- Fed Reserve 2016 Advanced Notice of Proposed Rulemaking

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