Banking and Finance Law Daily Wrap Up,TOP STORY—Fed's Tarullo gives glimpse of insurance company capital rules,(May 20, 2016)

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In a speech before the National Association of Insurance Commissioners' International Insurance Forum in Washington, D.C., Federal Reserve Board Governor Daniel K. Tarullo spoke about the Fed's "role in insurance regulation and supervision—both what it is and what it is not."

Tarullo began his speech by describing how the Dodd-Frank Act changed the Fed's role as regulator. Prior to the Dodd-Frank Act, the Fed's supervisory mandate was to protect the safety and soundness of and soundness of federally insured depository institutions affiliated with any kind of holding company. With the enactment of Dodd-Frank, the Fed's supervisory role was "sharpened" to ensure the safety and soundness of not only the holding company itself, but also its functionally regulated subsidiaries, including affiliated insured depository institutions; and regulate holding companies so as to promote the stability of the financial system as a whole. Also, the Fed became the primary federal regulatory for savings and loan holding companies, which includes insurance holding companies.

Supervisory approach. As for the overall supervision of insurance companies, Tarullo noted that there needs to be a distinction between insurance companies that Fed oversees solely because they own an insured depository institution and those that have been designated as systemically important by the Financial Stability Oversight Council.

For the first group of insurance companies, the Fed's supervisory efforts to date have focused on ensuring that the companies have strong internal controls and effective corporate governance, as well as satisfactory risk identification, measurement, and management. For firms designated as systemically important, the Fed's supervision has additionally emphasized capital and liquidity planning and positions, management of core business lines, and recovery and resolution planning.

Tarullo also discussed the three major regulatory initiatives that the Fed has underway for the supervision of insurance companies. One initiative is proposed reporting requirements for the systemically important insurance companies. The second initiative is enhanced corporate governance and risk-management standards for systemically important insurance companies. Tarullo noted that these standards will likely build on the core provisions of the Fed's consolidated supervisory framework for large domestic and foreign banking organizations, with appropriate adjustments to reflect these firms' predominantly insurance business model.

Capital. The third initiative is the formation of capital standards for insurance companies supervised by the Fed. Tarullo observed that there are "a lot of ideas out there as to how we should construct the capital requirements we will apply to insurance companies." He noted a variation of the European Union's Solvency II approach is "unpromising."

As for the approach that the Fed is likely to take, it "will be elaborated in … an advance notice of proposed rulemaking (ANPR) to be issued in the coming weeks." As for the contents of the ANPR, Tarullo stated that it will provide two different methodologies.

"Building Block Approach". The "Building Block Approach" would aggregate capital resources and requirements across the different legal entities in the group to calculate combined, group-level capital resources and requirements. The capital requirement for each regulated insurance or depository institution subsidiary generally would be based on the regulatory capital rules of that subsidiary's lead regulator—whether a state or foreign insurance regulator or a federal banking regulator for depository institutions. Tarullo noted that this approach would "efficiently leverage existing legal-entity-level regulatory capital frameworks that already apply to the various units of the supervised insurance group."

"Consolidated Approach". For systemically important insurance companies, the ANPR would likely to seek comment on what the Fed has been calling the "Consolidated Approach." The foundation of the Consolidated Approach would be consolidated financial information based on U.S. generally accepted accounting principles, with appropriate adjustments for regulatory purposes. Tarullo noted that the Consolidated Approach would "initially be relatively simple in design, a relatively small number of risk categories, but as the Fed gained experience it would have the option of making it increasingly granular in order to achieve greater risk sensitivity." Tarullo noted that the Consolidated Approach would "help prevent intra-group regulatory arbitrage opportunities and the potential for double leverage."

Companies: National Association of Insurance Commissioners

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