Date: September 9, 2022

To: Board of Governors

From: Staff[1]

Subject: Framework for the Supervision of Insurance Organizations

ACTIONS REQUESTED: Staff requests approval to publish in the Federal Register the attached draft Federal Register notice containing final supervisory guidance describing a framework for the supervision of depository institution holding companies significantly engaged in insurance activities (supervised insurance organizations). Staff also requests authority to make technical, non-substantive changes to the attached materials to prepare them for publication in the Federal Register.

EXECUTIVE SUMMARY:

- On February 4, 2022, the Board invited public comment on a proposed framework for the supervision of insurance organizations. The comment period closed on May 5, 2022. The Board received four comments on the proposal. Commenters were generally supportive of the proposal but also requested additional clarity on certain aspects and provided suggestions on potential changes. The draft final guidance reflects certain changes in response to the comments received and remains largely consistent with the proposal.

- The draft final guidance describes the Federal Reserve's supervisory framework for supervised insurance organizations, which consists of a risk-based approach to applying supervisory guidance, assigning supervisory resources, and conducting supervisory activities; a supervisory rating system; and a description of how examiners would work with state insurance regulators to limit the burden associated with supervisory duplication.

[1] Michael Gibson, Arthur Lindo, Thomas Sullivan, Lara Lylozian, Matthew Walker, Brad Roberts, and Joan Sullivan (Division of Supervision and Regulation); Mark Van Der Weide, Charles Gray, Dafina Stewart, Andrew Hartlage, Christopher Danello, and Evan Hechtman (Legal Division).

DISCUSSION:

I. Background

The Board has supervised a portfolio of depository institution holding companies significantly engaged in insurance activities since 2011, when provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[2] transferred supervision and regulation over savings and loan holding companies from the Office of Thrift Supervision to the Board.[3]

The risks arising from insurance activities are materially different from traditional banking risks, and in view of these differences, the Board has sought to appropriately adapt its supervision and regulation of this portfolio. Notably, this includes proposing a risk-based capital framework specifically designed for supervised insurance organizations, termed the Building Block Approach.[4] In addition, in 2018, the Board determined not to apply to these firms the supervisory rating systems applicable to other depository institution holding companies.[5] The draft final guidance represents a significant step in the continuation of the Board's risk-focused approach to supervision and regulation for these firms.

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[2] Pub. L. 111-203, 124 Stat. 1376 (2010).

[3] Dodd-Frank Act tit. III, 124 Stat. at 1520–70.

[4] Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 Fed. Reg. 57240 (October 24, 2019).

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

II. Overview of the Proposal and Key Changes in the Draft Final Guidance

On February 4, 2022, the Board invited public comment on a proposed framework for the supervision of insurance organizations.[6] The Board received four comments on the proposal. Commenters generally supported the proposal, and the final guidance remains largely consistent with the proposal.

Commenters requested additional clarity on certain aspects of the proposal, which staff addressed as described below.

III. Draft Final Guidance

The draft final guidance would establish a supervisory framework designed specifically to consider the unique risks of supervised insurance organizations resulting from their insurance activities. A depository institution holding company would be considered to be a supervised insurance organization if it is an insurance underwriting company or if over 25 percent of its consolidated assets are held by insurance underwriting subsidiaries. The framework consists of a risk-based approach to communicating supervisory expectations, assigning supervisory resources, and conducting supervisory activities; a supervisory rating system; and a description of how examiners would work with state insurance regulators to limit the burden associated with supervisory duplication.

Proportionality

Under the draft final guidance, the application of supervisory guidance and the assignment of supervisory resources would be based explicitly on a supervised insurance organization's complexity and risk profile. The Federal Reserve would classify supervised

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[6] 87 FR 6537 (February 4, 2022).

insurance organizations as either complex or noncomplex based on their risk profile, which would drive the application of supervisory guidance and the assignment of supervisory resources.

Complex firms would have a dedicated team of examiners responsible for consolidated supervision of the organization and would be subject to continuous monitoring and targeted examinations as necessary. Noncomplex firms would be subject to rating examinations and other supervisory activities, as necessary.

In response to the comments received, the draft final guidance clarifies the process for determining if a supervised insurance organization is complex (and thus would be subject to more intense supervisory oversight). The changes include eliminating the automatic complex classification for internationally active insurance groups, making public the work program used to support the complexity classification decision, and distinguishing the complexity classification from the risk assessment and risk profile. The draft final guidance also modifies the frequency of rating examinations for noncomplex supervised insurance organizations from annually to as long as every other year depending on the firm's risk profile.

Ratings

Since 2011, supervised insurance organizations have been assigned indicative ratings under the Board's existing framework. The draft final guidance would replace the indicative RFI ratings by establishing supervisory ratings applicable to this portfolio. Under the draft final guidance, these firms would be rated in each of three components: Capital Management, Liquidity Management, and Governance and Controls. Firms would be assigned one of four ratings for each component. The ratings are Broadly Meets Expectations, Conditionally Meets

Expectations, Deficient-1, and Deficient-2. The rating definitions would be designed for supervised insurance organizations with particular emphasis on the obligation that firms operate in a safe and sound manner and serve as a source of financial and managerial strength for their depository institution(s).

Incorporating the work of other supervisors

Federal Reserve examiners, consistent with statutory requirements, rely to the fullest extent possible on the information gathered and assessments developed by other relevant regulators. Because supervised insurance organizations have material insurance business lines, the draft final guidance describes how the Federal Reserve would leverage the work performed by state insurance regulators. In response to comments received, the draft final guidance emphasizes that Federal Reserve examiners recognize the differences between acceptable practices for banking and insurance operations and includes additional information on the ways in which Federal Reserve examiners incorporate the work of state insurance regulators.

RECOMMENDATIONS:

For the reasons discussed above, staff recommends that the Board approve the attached notice for publication in the Federal Register. Staff also recommends that the Board delegate to staff authority to make technical, non-substantive changes to the attached materials to prepare them for publication in the Federal Register.