Meeting Between Staff of the Federal Reserve Board and Insurance Industry Stakeholders
November 18, 2019

Participants: Linda Duzick, Matt Walker, Matti Peltonen, Brad Roberts, David Alexander, Andrew Hartlage, and Jonah Kind (Federal Reserve Board)

Mariana Gomez-Vock, David Leifer, Patrick Reeder, and Taylor Walker (American Council of Life Insurers); Martin Hansen (American International Group); Elizabeth Varley and David Weiser (Ameriprise); Amanda Coe, Joe Engelhard, Diana Keegan, Kevin Mackay, and Robert Rose (MetLife); Kristen DiCarmine, Qamar Islam, and Linus Waelti (New York Life); Andrew Vedder (Northwestern Mutual); Tom Gibbons (Pacific Life); Leanne Ness (Primerica); Ian Adamczyk, Benoit Bosi, Roman Gabriel, and Lauren Sarper (Prudential); Wayne Cimons, Margaret Nunne, and Tim Sparks (State Farm); Megan Duffy, Bret Hester, Jennifer Parkes, and Louis Senay (TIAA); Chris Conrad (Transamerica); Bill Jones, Alyssa Long, Erin Martinko, and Tate Wilson (USAA)

Summary: Staff of the Federal Reserve Board met with insurance industry representatives to discuss the Federal Reserve Board's notice of proposed rulemaking on risk-based capital requirements for depository institution holding companies significantly engaged in insurance activities (proposal). The representatives discussed their concerns and asked clarifying questions about the proposal, as set forth in the attachment.

Attachment

ACLI Questions for Discussion

Issue/Question #1: Is our interpretation that BBA is more restrictive on utilization of Tier 2 capital instruments than the Fed's bank capital rule, correct? If so, was there a reason why?

Comparison of limits on Tier 2 capital instruments for current banking rule vs. proposed BBA:

BANK CAPITAL VS. BBA REQUIREMENT		
	Banking Rule	**BBA Proposal**
Tier 1	4.5%	250% Required
Additional Tier 1/Tier 2	3.5%	Limited to 62.5% of Required Capital
Capital Buffer	2.5%	235% (only Tier 1)
Total including Buffer	10.5%	485%
Tier 2/ Total	3.5/10.5 = **33%**	62.5%/485% = **13%**

Table above illustrates that while Tier 2 instruments could comprise up to 33% of capital under current banking rule, only 13% could be Tier 2 instruments under the proposed BBA.

Issue/Question #2: Criteria for Qualification of Surplus Notes as Tier 2 capital – Do the criteria imply a public stock company won't be able to use surplus notes as a capital instrument (see footnote 72)?

Per definition of qualifying capital in BBA, an instrument must be ***subordinated to depositors and general creditors*** in order to be considered as qualifying capital

Per footnote #72 in BBA, Surplus notes are ***subordinated to policyholders, to claimant and beneficiary claims, and to all other classes of creditors*** other than surplus note holders;

Issue/Question #3: Can the Fed please discuss the Audit Requirement?

Will financial statements of non-regulated entities now need to be audited once BBA is effective?

Issue/Question #4: Can Fed discuss Target/Planned Effective Date?

Proposed Effective Date of January 2021 was stated on draft FR Q-1 form published by the FRB. Does this represent a current target date? What are the major milestones in the timeline to achieve this target effective date of Jan 2021? In terms of data gathered for reporting, how should "January 2021" be interpreted (e.g. effective for 12/31/2020 reporting or 12/31/2021 reporting)?

Issue/Question #5: Transitional element concerns/interpretation – Principle Based Reserving (PBR)

We interpret the rule's instructions to adjust out the effect of any grandfathering or transition measures to mean, among other things, that insurers should apply the NAIC's Principle Based Reserving methodology to all insurance products (including all in-force) for which the NAIC has implemented a PBR valuation methodology, even if the PBR valuation methodology only applies to products issued after a certain date. Can you please confirm if interpretation is correct?

Assuming the answer to the preceding question is yes, and understanding that PBR valuation methodologies are complex, does the FRB anticipate allowing insurers to use simplifying methods to approximate a PBR result for in-force insurance products where only new issues are subject to PBR valuation under the state regime?

***Issue/Question #6*:** The BBA mentions that the minimum capital requirement of 250% was creating by scaling RBC to 8% of RWA and then adding a "margin of safety to account for factors including any potential data or model parameter uncertainty in determining scaling parameters and an adequate degree of confidence in the stringency of the requirement." The BBA also notes that 250% is the midpoint between two existing supervisory intervention points (CAL and trend test RBC). If you translate an 8% total bank capital requirement using the BBA scalars, that would be equivalent to 160% (instead of 250%). Can you please elaborate on why you believe the margin of safety needs to exceed more than 150% of what their own formula, based on historical data, would suggest is appropriate?

Issue/Question #7: The scalars rely on historical data. How has the Fed accounted for changes in the insurance capital regime that have occurred over the years, in the scalars? For example, the use of stochastic methods for C3 and most recently, the changes that tax reform have had on RBC ratios.

Issue/Question #8: The proposal relies on a narrow interpretation of the Collins Amendment to justify the inclusion of the section 171 calculation. What added benefit do you believe the section 171 calc offers to Fed regulators? Why does the Fed feel it needs to apply the section 171 calculation? How can the industry best address those concerns?

Issue/Question #9: The proposal applies disparate treatment for asset-managers who are under a life insurance company vs. a subsidiary of a depository institution. Is it correct that this disparate treatment was inadvertent, or was there a rationale? We have developed a small amendment that we believe will remedy the situation and provide equal treatment to asset-managers, regardless of where they are located in the corporate structure. Is this something the Fed is interested in receiving?

Issue/Question 10: Can you provide an example of how the rule would apply to an insurer that is not an SLHC and has a top-tier holding company that does not underwrite insurance? In particular:

- Would the only the section 171 calc apply?
- Would the Board's generally applicable minimum risk-based capital requirement apply to the top-tier holding company following its election on treatment of its regulated insurance subsidiaries (i.e., to consolidate or not)?
- What approach would apply to an asset manager that is a subsidiary of the top-tier holding company?
- Are there elements worth noting regarding how the Fed's proposal would apply to such a company?

Issue/Question #11: At the global level, US members of the IAIS have pursued recognition of the loss absorbing capabilities of senior debt. The current form BBA however does not provide credit for senior debt. What is the basis for this difference? How can the industry best address this disconnect?