IPAC Working Group

Comment/Feedback on the Federal Reserve's Proposed Framework for the Supervision of Insurance Organizations

May 2, 2022

Background

The Insurance Policy Advisory Committee (IPAC) of the Board of Governors of the Federal Reserve System (Board) was formed by Congress in 2018 pursuant to section 211(b) of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The IPAC, whose members comprise a diverse committee of insurance industry experts, is an independent advisory group charged with providing information, advice, and recommendations to the Board on international capital standards and other insurance matters.

Given the IPAC's mandate and member composition, IPAC has determined it is appropriate to provide feedback to the Board on its recent proposal, Framework for the Supervision of Insurance Organizations (the Proposal). IPAC members collaborated to provide feedback and recommendations on the Proposal that consider the variety of supervised insurance organizations (SIOs). IPAC appreciates the opportunity to provide feedback on the Proposal and offers recommendations and suggested refinements.

The information contained in this presentation are the views offered by the IPAC. These views are their own and do not necessarily reflect those of the Board, its staff, or the employing companies and institutions of IPAC members.

Overview / Summary

The Working Group identified several areas where increased clarity would be beneficial to SIOs

- **Section A – Proportionality – Supervisory Activities and Expectations**
  - Subsection A.1 – Complex and Noncomplex SIOs
    - Clarify complexity determination and assessment factors, methodology, and encounters; differentiate between risk profile and assessment
  - Subsection A.2 – Supervisory Expectations
    - Ability to tailor supervisory guidance application to insurance and other functional lines of business within an SIO
- **Section B – Supervisory Ratings**
  - Reliance on state insurance or functional regulatory assessments in supervisory ratings
- **Section C – Incorporating the Work of Other Supervisors**
  - Detailed clarity on the nature and extent of coordination with and reliance on state insurance regulators to evaluate and assess SIO compliance and safety and soundness
- **Other Potential Categories of Supervised Firms**
  - Possible scenarios, not present in current SIOs, which may result in Board oversight of internationally active insurance groups (IAIGs) and nonbank systemically important financial institutions (nonbank SIFIs)
- **Special Circumstances Involving Certain Large Insurance Groups**
  - Clarify scope of application in Proposal of ability of Board to oversee nonbank SIFIs

Subsection A.1 – Complex and Noncomplex SIOs

Complexity Factors

- Question 1 - <u>What additional factors, if any, should the Board consider when considering the complexity of supervised insurance organizations?</u>
  - Access to capital markets under normal and stressed conditions and the effect of any federal preemption with respect to source of strength
  - Extent of interconnection between depository institution and an SIO
  - Source of funding noninsurance operations (e.g., deposits, securitization, private placements)
  - Statutory limitations on insurance holding company investment in noninsurance subsidiaries in some states and the effect of any federal preemption
  - Relative exposure of unregulated/unsupervised activities
  - Other factors that drive depository institution support from an SIO
- Supportive of including and incorporating state insurance and functional regulators' ratings and views as factors in determination of complexity of an SIO

Subsection A.1 – Complex and Noncomplex SIOs (cont.)

Complexity Factors

- Depository institution size alone should not determine complexity
  - Not directly representative of risk level or level of required supervision but should be considered against an SIO's total assets
- Specify weight given to each factor in determining complexity and provide methodology utilized
  - In addition to depository institution size, recommend as key weighted factors:
    - Breadth, nature and risk associated with products (e.g., whether focus is traditionally non-complex products, how much and what kind of commercial exposure exists)
    - Nature and extent of any entities or activities that are unregulated or unsupervised by other functional or prudential regulators
    - Degree of reliance on short-term funding
- With respect to the international exposure complexity factor, we suggest:
  - Including any *material* or *significant* international exposure as a factor
  - Weighing any international exposure against the complexity of the business and the degree to which the business is regulated and supervised
- Provide opportunity for an SIO to request review of complexity designation and consideration of weight given to each factor

Subsection A.1 – Complex and Noncomplex SIOs (cont.)

Risk Profiles and Risk Assessments

- Risk Profile
  - Clarify the role of, and purpose for, the risk profile
  - Clarify distinction between risk profile and risk assessment, which drives supervisory activities
- Risk Assessment
  - Confirm state insurance regulators' determinations will be relied upon in risk assessments, including ORSA
  - Recommend following factors be utilized to perform a risk assessment
    - Factors listed in the Proposal for determining complexity
    - Quality of enterprise risk management program
  - Recognize risks specifically material to business of insurance and tailor assessments to rely on state insurance or functional regulators' oversight of such risks
    - Capital management, liquidity, insurance pricing and reserving models, insurance activity cybersecurity/IT, reinsurance and related counterparty credit, investment credit, interest rate risk and asset liability management, catastrophe and non-catastrophe insurance risk
  - Clarify risk assessment methodology varies based on an SIO's lines of business
  - Clarify SIO engagement in risk assessment process
    - Opportunity for an SIO to provide additional information to inform risk assessment results
    - Risk assessment methodologies be shared with SIOs prior to conducting risk assessments

Subsection A.1 – Complex and Noncomplex SIOs (cont.)

Examination Activities

- Recommend examinations and other supervisory activities be adjusted to focus on material risks that are not already the subject of a state insurance examination or other state supervisory activity
  - Examples of material risks covered by state insurance examinations: Solvency, Governance, Risk Management
- Suggest Board coordinate timing of examinations and other supervisory activities of SIOs with banking, state insurance, and other functional and prudential regulators, as appropriate
  - Example – qualifying insurance companies under a three-year examination cycle with the state insurance regulator and banking subsidiary under an 18-month examination cycle with the OCC
  - When possible, acceptance of, or deference to, time period established by banking, state insurance, and other regulators
  - Noncomplex SIOs should be examined not more often than every other year, consistent with SR 13-21

SIO Determination

- Confirm that a non-underwriting holding company or firm that holds less than 25% of its assets as insurance underwriting assets will not be deemed an SIO
  - Clarify additional factors, if any, that will be utilized in determining an SIO
  - Specify how this proposal reconciles with the Building Block Approach proposal's definition of “financial entities"

Subsection A.2 – Supervisory Expectations

Tailoring Supervisory Expectations

- Supportive of tailoring supervisory activities based on an SIO's individual risk profile
- Recommend Proposal acknowledge that application of supervisory guidance and supervisory expectations will vary within and across an SIO (e.g., SR 08-8 tailoring risk and compliance programs based on their respective lines of business)
  - Expectations for risk management and compliance practices and programs should be applied differently to insurance and other lines of business than to banks
    - Examples of programs to recognize tailoring as appropriate: issues management, compliance risk management, operational risk management, debt/liquidity coverage, market conduct
  - Suggest tailoring supervisory activities for insurance and other functional lines of business to "material risk categories"
    - Capital management, liquidity, cybersecurity/IT, third party oversight, investment credit, interest rate risk and asset liability management, catastrophe and non-catastrophe insurance risk
  - Suggest reliance on the work of state insurance and other functional regulators where appropriate, e.g., non-catastrophe insurance, sales practices, model risk, operational fraud risk, operational losses, and other regulated areas of non-insurance lines of business (including, where applicable, financial, governance, compliance, and risk management practices)

Subsection A.2 – Supervisory Expectations (cont.)

Board Supervisory Guidance

- Suggest clarifying that SR letter references are not intended to increase supervisory expectations
- Recommend Proposal addresses in future guidance explicitly whether such guidance is applicable to SIOs and if future guidance does not address SIOs, then such future guidance is not applicable to SIOs
- Clarify expectations for managing liquidity risk most relevant to SIOs in relation to the depository institution
- SR 13-19 – Suggest adding "or successor" to Footnote 11 in the Proposal
  - If adopted as proposed in July 2021, Interagency Guidance on Third Party Relationships: Risk Management would rescind or supersede SR 13-19
- SR 12-17 – Consolidated Supervision Framework for Large Financial Institutions
  - Though not cited in the Proposal, SR 12-17 is applicable to some SIOs
  - Both the Proposal and SR 12-17 have the stated purpose of establishing a supervisory framework for institutions covered by the frameworks
    - Application of both 12-17 and Proposal may create duplication of effort and confusion for SIOs, supervisory staff and others
  - As the Proposal will provide the supervisory framework for SIOs, recommend SR 12-17 not be applicable to SIOs because it is superseded by the Proposal

Subsection A.2 – Supervisory Expectations (cont.)

Board Supervisory Guidance (cont.)

- SR 15-19 – Federal Reserve Supervisory Assessment of Capital Planning Positions for Firms Subject to Category II or III Standards
  - While not applicable to SIOs today, the Proposal indicates SR 15-19 will be applicable to complex SIOs. The related footnote indicates that the Board will focus on sections of SR 15-19 most relevant to complex SIOs.
  - As the most relevant provisions of SR 15-19 that would apply to SIOs are already present in the Proposal (e.g., governance and control expectations), it is not necessary to apply SR 15-19 to SIOs and doing so could create confusion for SIOs, supervisory staff, and others
  - Recommend the reference to SR 15-19 be removed from the final version of the Proposal

Section B – Supervisory Ratings

- Composite Rating
  - Question 6 – Should the final framework include a composite rating?
    - We support the absence of a composite rating
    - The rating components (i.e., Governance and Controls, Capital Management Liquidity Management) reflect core areas critical for an SIO to serve as a source of strength for its depository institution
    - Composite ratings would not provide new information beyond the rating components, and may obscure the importance of any single rating component
- Consistent with the Board's intent to reduce regulatory burden on SIOs, we believe the proposed ratings system would benefit from the following clarifications:
  - When determining ratings, rely on the work of state insurance and other functional regulators to the fullest extent possible
    - Use state insurance and other functional regulators' ratings and/or assessments of SIOs issued within the last 3 years (and where no material change of an SIO occurred since rating/assessment) to assist in determining ratings
  - Board should meet annually with state insurance and other functional regulators that oversee SIOs to understand and leverage assessments of SIOs

Section B – Supervisory Ratings (cont.)

- Proposal clarifications (cont.):
  - ‘Conditionally Meets Expectations’ definition for the Governance and Controls Component Rating provides an internal audit example for illustrative purpose
    - Suggest providing more concrete examples throughout all the ratings definitions
  - Acknowledge ‘Broadly Meets’ and ‘Conditionally Meets’ ratings allow for additional flexibility regarding material open supervisory matters
- Clarify that immaterial regulatory actions (i.e., not banking enforcement actions) by state insurance or other functional regulators (e.g., FINRA, SEC) do not necessarily impact an SIO’s ability to support the depository institution. Also, clarify that such actions be viewed with significance to an overall SIO and do not solely result in a Deficient 1 or Deficient 2 rating

Section C – Incorporating the Work of Other Supervisors

Consistent with the Board's intent to leverage the work of state insurance regulators, the Proposal would benefit from the following clarifications:

- Reliance on state insurance and other functional regulators to assess how SIOs manage compliance with insurance and related laws and regulations, including the manner, nature, and extent of oversight
- Reliance on state insurance and other functional regulators' financial risk assessments, as well as market conduct risk assessments, and material risk determinations without duplication of work
- Board's examination process is not intended to duplicate or replace supervision by state insurance and other functional and prudential regulators
- Reliance on state insurance and other functional regulator examination reports, including financial examinations, ORSA, and Annual Corporate Governance Disclosures
  - Suggest feedback be coordinated between Board examiners and state insurance and other functional regulators
- Additional work of state insurance and other functional regulators that can be leveraged: financial analysis review memos of quarterly and annual financial statements; annual registration statement (form B); material affiliate transaction filings (form D); (non-affiliate) material transaction filings; statements of actuarial opinion; state regulatory investment quantitative and qualitative restrictions

Other Potential Categories of Supervised Firms

The Proposal is drafted to be applicable to current SIOs, which are subject to Board supervision by virtue of their ownership of an insured depository institution. In the future, the Board may supervise insurance savings and loan holding companies (ISLHCs) that have been designated as an internationally active insurance group (IAIG) and insurance groups that have been designated as nonbank systemically important financial institutions (nonbank SIFIs). The circumstances below may pose supervisory considerations not presented by the current population of SIOs:

- Where in the future an insurance group, including an Internationally Active Insurance Group (IAIG), acquires a depository or vice versa. Legal authority:
  - 12 USC § 1842(c)(7) requires the Board to consider the effect of such acquisitions involving banks on US financial stability
  - 12 USC §§ 1467a(b)(4)(A) & 1844(c)(2)(A) authorize the Board to examine depository institution holding companies and all of their subsidiaries for threats to "the stability of the financial system of the United States"
- Where the Board ends up examining an insurance group that does not control a depository institution. Examples include:
  - A back-up examination of an insurance group at Financial Stability Oversight Council's (FSOC) request under Dodd-Frank § 112(d)(4)
  - Supervision of an insurer designated by FSOC as a nonbank SIFI

Special Circumstances Involving Certain Large Insurance Groups

To address these circumstances and clarify the scope of application of the Proposal, the supervisory framework should state that:

- The Board will supervise any insurance group that FSOC designates as a nonbank SIFI through a different supervisory program than the program created by the supervisory framework (such as, for example, the Large Institution Supervision Coordinating Committee)
  - The supervisory framework should also clarify whether the supervisory framework will apply to any back-up examination of an insurance group at FSOC's request under Dodd-Frank § 112(d)(4)
- The supervisory framework authorizes the Board to supervise any supervised entity that comes within its jurisdiction for financial stability risk

These provisions would assure any such insurance group that comes under Board oversight for macroprudential risk that its supervision would be tailored to insurance. These provisions would also help shield the Board from criticism for potential supervisory lapses.