

**FEDERAL RESERVE SYSTEM**

**12 CFR Parts 217, 238, and 252**

**[Docket No. R-1673]**

**RIN 7100-AF56**

**Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

**SUMMARY:** The Board of Governors of the Federal Reserve System is adopting risk-based capital requirements for depository institution holding companies that are significantly engaged in insurance activities. This risk-based capital framework, termed the Building Block Approach, adjusts and aggregates existing legal entity capital requirements to determine enterprise-wide capital requirements. The final rule also contains a risk-based capital requirement excluding insurance activities, in compliance with section 171 of The Dodd-Frank Wall Street Reform and Consumer Protection Act. The Board also is adopting a reporting form FR Q-1 related to the Building Block Approach. The capital requirements and associated reporting form meet statutory mandates and will help to prevent the economic and consumer impacts resulting from the failure of organizations engaged in banking and insurance.

**DATES:** This rule is effective on January 1, 2024.

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**SUPPLEMENTARY INFORMATION:**

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## I. Introduction

The Board of Governors of the Federal Reserve System (Board) is adopting a rule that establishes minimum risk-based capital requirements for certain depository institution holding companies significantly engaged in insurance activities (insurance depository institution holding companies). The rule establishes an enterprise-wide risk-based capital framework, termed the “building block” approach (BBA), that incorporates legal entity capital requirements such as the requirements prescribed by state insurance regulators, taking into account differences between the business of insurance and banking.

This final rule follows the issuance of two documents for comment by the Board. The first was the 2016 advance notice of proposed rulemaking (ANPR), in which the Board described the concept of the BBA as a capital framework and sought input on all aspects of its development at an early stage.<sup>1</sup> The Board considered this feedback and invited comment on a detailed BBA proposal in the notice of proposed rulemaking (NPR or proposal) issued in September 2019.<sup>2</sup> The NPR would have established risk-based capital requirements for insurance depository institution holding companies. As discussed in that proposal, insurance depository institution holding companies include depository institution holding companies that are insurance underwriting companies and depository institution holding companies that hold a significant percentage of total assets in insurance underwriting subsidiaries. In addition to the enterprise-wide capital requirement for insurance depository institution holding companies based on the BBA framework, the proposal would have applied a minimum risk-based capital

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<sup>1</sup> Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 FR 38631 (June 14, 2016).

<sup>2</sup> Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 84 FR 57240 (October 24, 2019).

requirement to the enterprise using the flexibility afforded under amendments enacted in 2014 to section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to exclude certain state- and foreign-regulated insurance operations (section 171 calculation).<sup>3</sup> The proposal included a buffer requirement that would have limited an insurance depository institution holding company's capital distributions and discretionary bonus payments if it did not hold sufficient capital relative to enterprise-wide risk, including risk from insurance activities. The proposed rule would have relied on the Board's authority under section 10 of the Home Owners' Loan Act (HOLA)<sup>4</sup> and section 171 of the Dodd-Frank Act.<sup>5</sup>

The Board is responsible for protecting the safety and soundness of certain banking organizations. This responsibility includes establishing minimum requirements for the capital of holding companies of groups that conduct both depository and insurance operations.<sup>6</sup> In the United States and other jurisdictions, the current risk-based capital assessment methodologies have been designed specifically for either insurance or banking.

In view of the above, the Board is adopting aggregation-based capital requirements for insurance depository institution holding companies. These capital requirements aggregate the required capital from insurance activities, as determined based on insurance capital rules set by the states or foreign jurisdictions, and banking activities, as determined based on banking capital rules. These requirements fulfill the Board's goal of designing an appropriate capital standard for insurance depository institution holding companies. Prior to this rule, savings and loan

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<sup>3</sup> Pub. L. 111-203, 124 Stat. 1376, 1435–38 (2010), as amended by Pub. L. 113-279, 128 Stat. 3017 (2014).

<sup>4</sup> 12 U.S.C. 1467a.

<sup>5</sup> 12 U.S.C. 5371.

<sup>6</sup> 12 U.S.C. 5371.

holding companies (SLHCs) with significant insurance operations have been excluded from the Board’s banking capital rule pending this rulemaking, while bank holding companies (BHCs) with significant insurance operations have been required to comply with the Board’s banking capital rule.

In addition to the NPR, the Board invited comment on a draft reporting form “Capital Requirements for Board-Regulated Institutions Significantly Engaged in Insurance Activities” (form FR Q-1) and associated instructions, which would gather data related to the BBA, and published a white paper describing how the BBA translated between the banking and insurance capital frameworks. The Board also launched a quantitative impact study (QIS) alongside the NPR using the draft reporting form. The comments received on the NPR and on the reporting form and instructions, as well as the QIS results, have informed this final rule and are discussed in the following sections. The reporting form and instructions are being finalized along with this final rule with certain changes in response to the comments.

#### **A. Background**

In response to the 2007-09 financial crisis, Congress enacted the Dodd-Frank Act, which, among other purposes, was enacted to ensure appropriate supervision of depository institution holding companies without regard to charter type of their insured depository institution subsidiaries and to streamline the supervision of such holding companies. In furtherance of these purposes, Title III of the Dodd-Frank Act expanded the Board’s supervisory role by transferring to the Board all supervisory functions related to SLHCs and their non-depository subsidiaries. As a result, the Board became the federal supervisory authority for all depository institution

holding companies, including insurance depository institution holding companies.<sup>7</sup> Concurrent with the expansion of the Board’s supervisory role, section 616 of the Dodd-Frank Act amended HOLA to provide the Board express authority to adopt regulations or orders that set capital requirements for SLHCs.<sup>8</sup>

Any capital requirements the Board may establish for SLHCs are subject to minimum standards under the Dodd-Frank Act. Specifically, section 171 of the Dodd-Frank Act requires the Board to establish minimum risk-based and leverage capital requirements on a consolidated basis for depository institution holding companies. These requirements must be not less than the capital requirements established by the federal banking agencies to apply to insured depository institutions under the prompt corrective action regulations implementing section 38 of the Federal Deposit Insurance Act,<sup>9</sup> nor quantitatively lower than the capital requirements that applied to these institutions when the Dodd-Frank Act was enacted.

Section 171 of the Dodd-Frank Act was amended in 2014 (2014 Amendment) to provide the Board flexibility when developing consolidated capital requirements for insurance depository institution holding companies.<sup>10</sup> The 2014 Amendment permits the Board, in establishing minimum risk-based and leverage capital requirements on a consolidated basis, to exclude

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<sup>7</sup> Pub. L. 111–203, title III, section 301, 124 Stat. 1520 (2010).

<sup>8</sup> Dodd-Frank Act 616(b); HOLA Sec. 10(g)(1). Under Title I of the Dodd-Frank Act, the Board also supervises any nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Board. Under section 113 of the Dodd-Frank Act, the FSOC may designate a nonbank financial company, including an insurance company, to be supervised by the Board. Currently, no firms are subject to the Board’s supervision pursuant to this provision.

<sup>9</sup> 12 U.S.C. 1831o. The floor for capital requirements established pursuant to section 171 of the Dodd-Frank Act, referred to as the “generally applicable” requirements, is defined to include the regulatory capital components in the numerator of those capital requirements, the risk-weighted assets in the denominator of those capital requirements, and the required ratio of the numerator to the denominator.

<sup>10</sup> Pub. L. 113-279, 128 Stat. 3017 (2014).

companies engaged in the business of insurance and regulated by a state insurance regulator, as well as certain companies engaged in the business of insurance and regulated by a foreign insurance regulator.

Section 171 of the Dodd-Frank Act also provides that the Board may not require, under its authority pursuant to section 171 of the Dodd-Frank Act or HOLA, a supervised firm that is also a state-regulated insurer and files financial statements with a state insurance regulator or the National Association of Insurance Commissioners (NAIC) utilizing only Statutory Accounting Principles (SAP) to prepare such financial statements in accordance with U.S. generally accepted accounting principles (GAAP).<sup>11</sup> The Board notes that, unlike GAAP, SAP does not include an accounting consolidation concept. As discussed in detail in subsequent sections of this Supplementary Information, the BBA is thus an aggregation-based approach, designed to comprehensively capture risk, including all material risks, at the level of the entire enterprise or group.

The Board is adopting the BBA in this final rule in order to set risk-based capital requirements for BHCs and SLHCs that are significantly engaged in insurance activities.

## **B. Description of the Building Block Approach**

As adopted in this final rule, the BBA aggregates the available capital and required capital positions of certain entities determined to be building block parents in order to determine the capital position of top-tier supervised insurance depository institution holding companies (supervised insurance organizations or SIOs). The BBA expresses such a capital position as a BBA ratio, which is the ratio of the aggregated available capital to the aggregated required

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<sup>11</sup> [12 U.S.C. 5371\(c\)\(3\)\(A\)](#).

capital of the enterprise.<sup>12</sup> The SIO must maintain a BBA ratio of at least 250 percent and a capital conservation buffer of 150 percent, resulting in a total requirement of 400 percent.

The BBA groups legal entities together into building blocks to calculate the BBA ratio. These building blocks are developed by grouping entities in the supervised insurance organization that are covered under the same regulatory capital framework. By grouping related legal entities in this manner, the BBA maintains the regulatory framework developed for the particular business activity and reduces regulatory burden. Without grouping in this type of capital construct, a large SIO would need to perform a capital calculation for each of hundreds of legal entities. Typically, the building blocks follow other existing legal-entity capital regulations. For instance, a typical U.S. legal entity that offers life insurance is assessed together with most of its subsidiaries using its existing regulatory capital framework, NAIC Risk-Based Capital (RBC). Depository institutions and their subsidiaries are assessed using federal banking capital rules. The BBA does, however, sometimes deviate from existing regulatory groupings to ensure risks are appropriately captured. For example, certain financial companies owned by insurance companies are not directly subject to capital regulation. For these companies, the parent's regime assesses a simplified capital charge that may not appropriately reflect the risk. The BBA separately assesses, applies a capital regime to, and aggregates these companies if they are material and engage in financial activities and their risks would not otherwise be appropriately measured.<sup>13</sup>

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<sup>12</sup> When aggregating required capital for the denominator, the BBA follows NAIC Risk-Based Capital in using the Authorized Control Level (ACL) risk-based capital. This is the amount of capital below which a state insurance regulator would be authorized to take control of the company.

<sup>13</sup> For example, it would typically be inappropriate to assess the risk of a material financial subsidiary engaging primarily in derivative transactions by application of a risk charge applied to its net equity.

The BBA makes certain adjustments to the required and available capital of entities when preparing the building blocks for aggregation. Some of these adjustments avoid double counting capital or risk, others increase comparability among SIOs, while others are intended to align with certain aspects of the banking capital requirements to reduce the potential for arbitrage. One such adjustment is requiring all capital instruments to meet certain criteria and subjecting certain types of capital instruments to limits. These criteria and limits substantively match those applied to other depository institution holding companies.

The BBA aggregates the adjusted capital positions of the building blocks to calculate an SIO's capital position. To enable aggregation of the output of different capital frameworks, the BBA includes a translation mechanism called scaling. Scaling converts a capital position from one capital framework to its equivalent in another capital framework. The BBA then sums the scaled, adjusted capital position of each building block to calculate an SIO's capital position. This aggregated capital position is compared to the minimum requirement and capital conservation buffer discussed above.

### **C. Summary of comments received on the NPR and form FR Q-1**

The Board received 18 substantive comment letters on the proposal and several recommendations from the Board's Insurance Policy Advisory Committee. Comments were received from insurers supervised by the Board, insurers not supervised by the Board, insurance trade groups, a U.S. Senator, and the NAIC.

Most commenters supported the BBA's general framework, which aggregates existing capital requirements to determine an enterprise-wide capital requirement. Commenters strongly preferred applying this framework, rather than other frameworks like the banking capital rules or the Insurance Capital Standard, to depository institution holding companies that are significantly

engaged in insurance activities. The Insurance Capital Standard is being developed by the International Association of Insurance Supervisors. Indeed, certain commenters argued that the BBA should further leverage existing insurance capital requirements. Although commenters were supportive of the framework, some commenters expressed concerns with the level of detail that would be required in form FR Q-1 due to the proposed requirement to report assets and liabilities of inventory companies.

Specific comments are discussed below in the sections that follow. Some of the main issues that were raised by commenters include:

*Section 171 Calculation* – Most commenters argued that the section 171 calculation was flawed and should not be adopted. Commenters argued the BBA would still comply with section 171 of the Dodd-Frank Act without this calculation.

*Calibration* – Most commenters supported setting the BBA’s requirement equal to other banking capital requirements based on the indicated results from the scaling white paper, rather than including an upward adjustment designed to account for uncertainty. These commenters contended that the upward adjustment would have resulted in excess conservatism.

*Qualifying Capital Instruments and Limits* – Most commenters argued that the Board’s proposed capital instrument qualification criteria were too narrow and that senior debt should qualify as capital, although several commenters and the Board’s Insurance Policy Advisory Committee disagreed. Some commenters and the Board’s Insurance Policy Advisory Committee also argued for increasing the proposed limits on less loss-absorbing tiers of capital instruments. Some commenters also argued that surplus notes should qualify as tier 1 capital and if they are tier 2, then no limits should apply.

*Insurance Adjustments* – Commenters expressed diverging opinions on the proposed adjustments to reduce differences among states in insurance capital regulation.

Along with the NPR, the Board also invited comments about related work on the International Association of Insurance Supervisors' Insurance Capital Standard. In the NPR, the Board asked for the comparative strengths and weaknesses of both approaches. The Board appreciates the comments received on this work and will take these comments into consideration in the ongoing International Association of Insurance Supervisors deliberations.

#### **D. Main changes in the final rule and Form FR Q-1**

The final rule differs from the proposal in several ways. One change relates to the capital conservation buffer. The final rule includes a 150 percent capital conservation buffer, rather than the 235 percent buffer proposed in the NPR. This smaller capital conservation buffer better aligns the BBA's stringency with the Board's banking capital rule. With this change, the BBA's total capital requirement equals the total requirement applied to most other banking organizations, as estimated based on the parameters derived in the Board's scaling white paper.

The final rule includes an additional tier of capital instruments, additional tier 1 capital, that is eligible as available capital. The proposal only included two tiers of capital because no SIO had issued additional tier 1 capital. Commenters requested its addition in order to allow SIOs flexibility in their capital structures. In order to provide such flexibility, and be consistent with the Board's banking capital rule, the final rule includes this additional capital tier. The additional tier 1 capital limit has been set at 100 percent of the building block capital requirement for the top-tier parent. Any amount of additional tier 1 capital above this amount would be eligible for inclusion as tier 2 capital, subject to limitations on the inclusion of tier 2 capital instruments.

The final rule also increases a proposed limit to 150 percent on the amount of tier 2 capital instruments that could have been counted toward the building block capital requirement

of a top-tier parent holding company in an SIO. Under the proposal, the BBA would have limited tier 2 capital instruments to be no more than 62.5 percent of the building block capital requirement for the top-tier parent. Commenters expressed concern that the conservative nature of statutory accounting distorts the ratio of tier 2 capital instruments to common equity tier 1 capital which causes the 62.5 percent to be overly conservative.

The proposal included an adjustment that would have removed the effects of legacy treatment or transitional measures under a capital framework in determining capital requirements. Some commenters expressed concerns with the burden associated with adjusting capital resources to eliminate the impact of transitional provisions or legacy treatment when there are changes in an underlying capital regime. Some commenters were particularly concerned with having to restate legacy business under the NAIC Principles Based Reserving Standard (PBR) for life insurance reserves. PBR was adopted only prospectively by the NAIC and states. The final rule maintains the legacy treatment and transitional requirements for consistency in measurement, but provides a simple factor-based approximation rather than a full PBR calculation to the legacy reserves. This approach will allow for consistency for the measurement of life insurance reserves while minimizing burden.

In addition to the changes discussed above, the final rule simplifies the insurance adjustments, increases the limits on certain capital instruments, and eliminates an exception of certain asset managers from being material financial entities, and reduces the burden of the proposed form FR Q-1.

The Board is also making changes to the reporting form FR Q-1 as part of this final rule. The final form FR Q-1 is less burdensome than in the proposal. In particular, SIOs will not need to report the assets and liabilities of all subsidiaries. Numerous companies said providing this information would be difficult. Additionally, the annual due date for form FR Q-1's has been

moved back from March 15 to March 31 to allow companies additional time to complete the reporting template after their statutory filings are due.

## **II. Effective Date and Scope**

### **A. Scope**

The proposal would have applied to SLHCs significantly engaged in insurance activities. Under the proposal, a firm would have been subject to the BBA if the top-tier SLHC were an insurance underwriting company or the top-tier SLHC, together with its subsidiaries, if 25 percent of its total consolidated assets were in insurance underwriting subsidiaries (other than assets associated with insurance underwriting for credit risk related to bank lending). For purposes of this threshold, a supervised firm would have calculated its total consolidated assets in accordance with U.S. GAAP, or, if the firm does not calculate its total consolidated assets under U.S. GAAP for any regulatory purpose (including compliance with applicable securities laws), the company would have been permitted to estimate its total consolidated assets, subject to review and adjustment by the Board. The proposal also would have permitted the Board to determine to apply the BBA to another Board-regulated institution.<sup>14</sup>

As consolidated supervisor of the top-tier depository institution holding company of an insurance depository institution holding company, the Board proposed to include, within the scope of the BBA calculation, all owned or controlled subsidiaries of this top-tier parent.

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<sup>14</sup> The preamble to the proposal indicated that this type of determination may be appropriate with respect to, for example, an intermediate holding company, if its top-tier parent company were primarily engaged in non-financial commercial activity.

The NPR sought comments about whether the BBA should apply to BHCs. The proposal would have excluded BHCs; however, the NPR noted the Board would consider subjecting BHCs significantly engaged in insurance activities to the BBA in the final rule in light of the enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act.<sup>15</sup> This Act allowed federal savings associations with total consolidated assets of up to \$20 billion, as reported to the Office of the Comptroller of the Currency (OCC) as of year-end 2017, to elect to operate as covered savings associations.<sup>16</sup>

Four commenters addressed the scope of the BBA in their comments. One commenter supported applying the BBA to BHCs significantly engaged in insurance activities. Two commenters asked for clarifications related to 25 percent asset test. These commenters noted that some SIOs do not calculate consolidated assets and contended that the Board legally cannot require GAAP financial statements from certain insurers. They asked that the asset test be aligned the Board's Regulation TT, which concerns the assessment of fees from certain Board-regulated companies based on their total assets and contains a provision for estimating total assets in the absence of GAAP statements.<sup>17</sup> One commenter recommended that the BBA include additional flexibility to exclude certain companies within an SIO from the BBA and instead treating a subsidiary company as if it were the top tier. This commenter was concerned that the Board may lack the legal authority to select a mid-tier holding company as the top-tier holding company for purposes of the BBA when the insurance company is controlled by a

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<sup>15</sup> Pub. L. 115-174, 132 Stat. 1296 (2018).

<sup>16</sup> EGRRCPA section 206. With limited exceptions, a covered savings association has the same rights and privileges, and is subject to the same duties, restrictions, penalties, liabilities, conditions, and limitations, as a national bank that has its main office in the same location as the home office of the covered savings association. The Board generally treats a company that controls a covered savings association as a bank holding company.

<sup>17</sup> 12 CFR part 246.

company significantly engaged in non-insurance commercial activities. Another commenter suggested explicitly excluding certain non-operating holding companies from the BBA.

Based on the comments received, as well the Board's policy to achieve regulatory consistency across both types of depository institution holding companies, the final rule adopts the proposed scope of the BBA framework with a change to include BHCs significantly engaged in insurance activities. The final rule does not alter the proposed 25 percent asset test but does address the comments received. The final rule will instead allow SIOs that do not calculate consolidated GAAP assets to provide an estimate of consolidated total assets. The calculation would be subject to review and adjustment by the Board.

The final rule does not amend the Board's authority to modify the scope of the BBA, as the reservations of authority in the final rule and elsewhere in the banking capital rule are sufficient to allow the Board to exclude from the BBA a top-tier holding company that is a controlling depository institution holding company under this rule. While possible, this likely will not occur frequently due to statutory mandates to ensure that depository institution holding companies can serve as a source of strength to their depository institutions, as well as other policy considerations. The final rule does streamline the reservation of authority to clarify the Board's authority to require an SIO to make certain decisions involved in the BBA calculation, such as the identification of the top-tier building block parents, building block parents, and Material Financial Entities (MFEs).

## **B. Effective Date**

The NPR did not propose an effective date for the BBA framework. Several commenters requested delaying the BBA's effective date significantly beyond its finalization. One suggested having at least a two-year transition period from the effective date, or a longer transition period if

the finalized total capital requirement were above 400 percent. This commenter also suggested providing a further opportunity for public comment regarding any changes related to the proposed form FR Q-1, which could impact the effective date because form FR Q-1 is needed to effectuate the BBA's requirements. Another commenter suggested that the first filing date of the associated form FR Q-1 should be two years after the publication date of the final rulemaking. One commenter suggested using a five-year monitoring period, like that used by the International Association of Insurance Supervisors for its Insurance Capital Standard, before making the BBA effective. Other commenters argued that there is a need to delay certain of the proposed requirements of form FR Q-1. The proposed form FR Q-1 attestation section of the cover page would have required reporting firms to attest that effective controls were in place throughout the reporting period. Because form FR Q-1 was proposed as an annual report, commenters asserted that at least a one-year delay would be needed between the final rule becoming effective and the first form FR Q-1 attestation requirement to avoid it applying retroactively.

Under the final rule, companies must comply with most of the BBA beginning on January 1, 2024. Beginning at that time, companies are expected to hold capital sufficient to comply with the BBA's minimum requirement.

Companies must first report on their capital adequacy under the BBA capital requirement as of December 31, 2024. As described above, the comments received on form FR Q-1 primarily related to reporting of legal entities, filing date, and reporting of results. The Board received only non-substantive clarification requests through the QIS process on form FR Q-1. Given that only small technical changes were made to the proposed reporting form based on these comments and requests for clarification, the Board elected not to seek further comments on form FR Q-1. Additionally, the January 1, 2024, effective date of this rules allows firms time to ensure that effective internal controls are in place for the first reporting date. As such, the first

form FR Q-1 submissions, which will be due in March 2025, must include the attestation section of the cover page.

Firms that are not initially subject to the BBA, but subsequently become subject to the BBA during January through June in a year, will be required to begin submitting the form FR Q-1 in March of the calendar year following the year they become subject to the BBA, except for the attestation section of the cover page, which must be submitted beginning with the firm's second form FR Q-1. Firms that are not initially subject to the BBA, but subsequently become subject to the BBA during July through December in a year, will be required to begin submitting the form FR Q-1 in March of the second calendar year following the year they become subject to the BBA, except for the attestation section of the cover page, which must be submitted beginning with the firm's second form FR Q-1.

The final rule also clarifies the timing of the application of the buffer. In the absence of any enterprise-wide group income calculation, the BBA links the amount of eligible distributions under the capital conservation buffer with changes to building block available capital. Calculating the change in building block available capital requires two years of BBA data, meaning that firms would not be able calculate their permissible distributions before completing their second form FR Q-1. Consequently, the BBA's buffer requirements are effective starting with the submission of a firm's second form FR Q-1.<sup>18</sup> In the year proceeding the second form FR Q-1 submission, the Board expects firms to consider the pending requirements and to set their distribution policies to avoid needing a large and sudden change in payouts at the effective date.

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<sup>18</sup> See 12 CFR 217.306.

### **III. Dodd-Frank Act Capital Calculation**

The proposal would have applied a separate minimum risk-based capital requirement calculation to insurance depository institution holding companies, which would have used the flexibility afforded by the 2014 Amendment to exclude certain state- and foreign-regulated insurance operations and to exempt top-tier insurance underwriting companies from the risk-based capital requirement. The proposed section 171 calculation would have applied the Board's existing minimum risk-based capital requirements to a top-tier insurance SLHC on a consolidated basis when this company is not an insurance underwriting company. In the case of an insurance SLHC that is an insurance underwriting company, the proposal would have applied the requirements to any subsidiary SLHC of an insurance SLHC, where the subsidiary SLHC is not itself an insurance underwriting company, provided that the subsidiary SLHC is the farthest upstream non-insurer SLHC (i.e., the subsidiary SLHC's assets and liabilities are not consolidated with those of a holding company that controls the subsidiary for purposes of determining the parent holding company's capital requirements and capital ratios under the Board's banking capital rule) (an insurance SLHC mid-tier holding company).

The proposed section 171 calculation would have been implemented by amending the definition of "covered savings and loan holding company" for the purposes of the Board's banking capital rule.<sup>19</sup> The proposal would have resulted in an insurance SLHC becoming a covered SLHC subject to the requirements of the Board's banking capital rule unless it was a legacy unitary SLHC<sup>20</sup> that derived 50 percent or more of its total consolidated assets or 50

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<sup>19</sup> 12 CFR 217.2.

<sup>20</sup> This term refers to a SLHC that meets the requirements of section 10(c)(9)(C) of HOLA (12 U.S.C. 1467a(c)(9)(C)).

percent or more of its total revenues on an enterprise-wide basis (as calculated under GAAP) from activities that are not financial in nature. However, the proposal would not have required top-tier SLHCs that are engaged in insurance underwriting and regulated by a state insurance regulator, or certain foreign insurance regulators, to comply with the generally applicable risk-based capital requirements.<sup>21</sup> Instead, those requirements would have applied to any insurance SLHC mid-tier holding companies.

As noted above, commenters opposed this calculation and argued that the BBA would comply with section 171 of the Dodd-Frank Act without this additional calculation. Commenters contended that the proposal without the section 171 calculation meets the Board's statutory requirements under section 171 of the Dodd-Frank Act, as amended by the 2014 Amendment, to establish minimum risk-based capital requirements for these companies. Commenters argued that the section 171 calculation would introduce burdens and costs that do not meaningfully advance the Board's supervisory objectives. Some commenters also contended that the 2014 Amendment indicates that Congress did not intend for the Board to implement the section 171 calculation. Commenters argued that the section 171 calculation duplicates certain requirements of the BBA and inappropriately treats firms differently according to legal form.

The Board considered the comments and has decided to include the section 171 calculation in the final rule. Section 171 of the Dodd-Frank Act generally requires that the minimum risk-based capital requirements established by the Board for depository institution holding companies apply on a consolidated basis. The Board believes that including the section

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<sup>21</sup> In accordance with section 171 of the Dodd-Frank Act, a foreign insurance regulator that falls under this provision is one that “is a member of the [IAIS] or other comparable foreign insurance regulatory authority as determined by the Board of Governors following consultation with the State insurance regulators, including the lead State insurance commissioner (or similar State official) of the insurance holding company system as determined by the procedures within the Financial Analysis Handbook adopted by the [NAIC].”

171 calculation accords with the plain language meaning of section 171 of the Dodd-Frank Act, considering also the use of terms in section 171 elsewhere in the federal banking laws, and the legislative history of section 171 and the 2014 Amendment. Moreover, the Board believes that the treatments for insurance activities under the section 171 calculation is an appropriate exercise of the discretion given to the Board by Congress in the 2014 Amendment.

The proposed section 171 calculation would have allowed an insurance SLHC subject to the generally applicable risk-based capital requirements (i.e., that is not a top-tier insurance underwriting company) to elect not to consolidate the assets and liabilities of all of its subsidiary state-regulated insurers and certain foreign-regulated insurers. The proposal would have provided two alternative approaches if this election is made. Under the first alternative, the holding company could have elected to deduct the aggregate amount of its outstanding equity investment in its subsidiary state-regulated and certain foreign-regulated insurers, including retained earnings, from its common equity tier 1 capital elements. Under the second alternative, the holding company could have included the amount of its investment in its risk-weighted assets and assigned to the investment a 400 percent risk weight, consistent with the risk weight applicable under the simple risk-weight approach in section 217.52 of the Board's banking capital rule to an equity exposure that is not publicly traded.<sup>22</sup>

A commenter expressed concerns regarding the proposed equity-deduction treatment, contending that it would be unduly punitive. The commenter also urged the Board to permit firms to risk-weight a company's net equity investment in insurance operations consistently with NAIC RBC's treatment of equity investments in affiliates. The commenter also suggested that the Board permit firms to satisfy the section 171 calculation through use of the Small Bank

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<sup>22</sup> 12 CFR 217.52(b)(6).

Holding Company and Savings and Loan Holding Company Policy Statement and measuring compliance with the applicability thresholds of that statement after applying the election not to consolidate the assets and liabilities of subsidiary state-regulated insurers and certain foreign-regulated insurers.

In the final rule, firms that elect not to consolidate the assets and liabilities of all of its subsidiary state-regulated insurers and certain foreign-regulated insurers have the option to choose between the proposed treatments. This optional provision should provide firms with greater flexibility to apply an appropriate treatment in view of a firm's individual structural and other business circumstances. In the final rule, a firm that makes such an election and chooses to risk-weight its net equity investment in the deconsolidated subsidiaries must apply a risk weight of 400 percent, consistent with the proposal. The Board believes that this treatment is appropriate considering the risk weights applied to non-publicly traded equity exposures. Finally, a firm may not comply with the section 171 calculation through use of the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement.<sup>23</sup> This policy statement states expressly that the statement applies only to holding companies that are "not engaged in significant nonbanking activities either directly or through a nonbank subsidiary";<sup>24</sup> the section 171 calculation applies only to companies that are members of a holding company organization that is significantly engaged in insurance activities, a nonbank activity.

#### **IV. Minimum Capital Requirement and Capital Conservation Buffer**

The proposal was designed to produce an enterprise-wide risk-based capital requirement that is not less stringent than the results derived from the Board's banking capital rule. To enable

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<sup>23</sup> 12 CFR part 225 app. C.

<sup>24</sup> Id. section 1.

aggregation of available capital and capital requirements across different building blocks, the proposal included a mechanism (scaling) that would have translated a capital position under one capital framework to its equivalent in another capital framework.<sup>25</sup> At the enterprise level, the proposal would have applied a minimum risk-based capital requirement that leverages the minimum requirement from the Board’s banking capital rule, expressed as its equivalent value in terms of the BBA ratio based on the Board’s published scaling white paper. In addition to this equivalent value, the proposal would have also included a margin of conservatism to provide a heightened degree of confidence that the BBA’s requirement would be compliant with section 171 of the Dodd-Frank Act, which requires the BBA to be “not less than” the Board’s banking capital requirements. In addition to complying with section 171 of the Dodd-Frank Act, calibrating the BBA to the same stringency level as the banking capital requirements minimizes the incentive for depository institution holding companies to acquire or sell insurance operations due to disparate capital requirements.

The proposal would have established a minimum BBA ratio of 250 percent and a capital conservation buffer of 235 percent. Together, these would have created a 485 percent total requirement. Insurers that breach this total requirement would have faced limits on capital distributions such as dividend payments and on discretionary bonus payments. The proposed minimum ratio, 250 percent, would have aligned with the midpoint between two prominent, existing state insurance supervisory intervention points, the “company action level” and “trend test level” under state insurance RBC requirements. To determine the appropriate threshold for a

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<sup>25</sup> Two building blocks under two different capital frameworks cannot typically be added together if, as is frequently the case, each framework has a different scale for its ratios and thresholds. As discussed below in section VII, the BBA proposes to scale and equate capital positions in different frameworks through analyzing historical defaults under those frameworks.

capital conservation buffer under the BBA, the Board took a similar approach to how it determined the minimum requirement. The full amount of the buffer under the Board's banking capital rule, 2.5 percent, translates to approximately 235 percent under the NAIC RBC framework. This translated buffer threshold would have been applied in the BBA.

Commenters criticized the proposed margin for conservatism and indicated that proposed minimum capital requirements and total capital requirements are significantly higher than the banking capital requirements. Some of these comments distinguished between including margins for conservatism in the minimum and total capital requirements. Consequently, while most commenters opposed including the margins in the total requirement, only some opposed uplifting the minimum requirement. Commenters justified this nuance because section 171 of the Dodd-Frank Act applies to only the minimum requirement. Legally, any margin included in the minimum requirement could be offset by a smaller capital conservation buffer. This would reduce the BBA's total requirement from 485 percent to 400 percent.<sup>26</sup> Commenters argued that the margin could competitively disadvantage SIOs as compared to other insurers or alternatively create externalities for companies not subject to the rule by changing industry-wide perceptions of capital adequacy.

Several commenters also argued that other aspects of the BBA are excessively conservative. These commenters criticized the BBA for the lack of diversification credit between entities in the group, treatment of captive reinsurance transactions, and criteria for

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<sup>26</sup> The proposal's capital requirement included an approximately 85 percent increase over the best-estimate translation to account for the uncertainty. That is, the best-estimate translation of an 8 percent total capital ratio is a BBA ratio of near 165 percent. This was uplifted to a 250 percent proposed requirement in the proposal. Removing this 85 percent uplift from the buffer reduces the proposed 485 percent total BBA ratio requirement to 400 percent. A 400 percent BBA ratio requirement aligns with the best-estimate translation of a 10.5 percent total capital ratio.

including capital instruments in available capital. Several commenters argued the BBA's capital requirements should be reduced in order to offset these conservative aspects of the framework.

Some commenters suggested fundamental changes to the calibration of the BBA. A few commenters argued that the BBA's requirements should not equal those applied to other banking organizations. Two commenters suggested instead tailoring the BBA's requirements to the loss experience of insurers. Two other commenters argued for eliminating the capital conservation buffer, either because insurance does not create systemic risk or because subsidiary depository institutions already are subject to a buffer requirement. Finally, one commenter argued that any capital requirements in excess of state insurance capital requirements would be unlawful and inappropriate. In the alternative, this commenter argued that an SIO buffer should depend on the size of its depository institution.

Commenters also raised concerns about the impact of breaching the BBA requirements and how they would interact with the NAIC RBC requirements. First, two commenters disagreed with limiting policyholder dividends when the BBA's total requirement is breached. Second, some commenters questioned how the BBA's requirements would interact with NAIC RBC, which is calibrated differently. An additional commenter requested clarification of the impact of not meeting the total capital requirement.

Based on the comments received, the Board has decided to modify the proposed calibration of the BBA. Most significantly, the Board has removed the margin from the proposed capital conservation buffer, dropping the BBA's total requirement from 485 percent to 400 percent.

Like the proposal, the final rule attempts to calibrate the BBA to the same level of stringency as the Board's banking capital rules. The BBA takes into account the different risks involved in insurance activities, on the one hand, and banking activities, on the other, through its

aggregation process, rather than through an altered calibration or by eliminating the capital conservation buffer. While some commenters suggested that the BBA’s calibration should be tailored to insurance, no commenter explained either how or why engaging in insurance activities should change the stringency of capital requirements that apply to a bank holding company or SLHC.<sup>27</sup>

To ensure safety and soundness of the SIOs, the BBA’s minimum capital requirement includes a margin. This margin ensures, to a high degree of confidence, that the BBA’s minimum requirement is not less than the banking capital requirements. The margin’s size corresponds to the upper bound of a 95 percent confidence interval on the BBA’s calibration from the scaling regressions.<sup>28</sup> Sensitivity tests of the calibration using different assumptions also informed the analysis.<sup>29</sup> Consequently, the final rule does not include a margin for the capital conservation buffer. As a result, the BBA’s total requirement equals the total requirement applicable to most other banking organizations.

The minimum capital ratio of 250 percent has not been reduced in the final rule in response to the comments about the proposal’s alleged conservatism in its treatment of certain capital instruments, application of the banking rules to unregulated entities, lack of

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<sup>27</sup> A commenter contended that the proposal was inconsistent with the McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq.* The Board believes that section 5 of the Bank Holding Company Act, section 10(g) of the Home Owners’ Loan Act, and section 171 of the Dodd-Frank Act provide authority for the Board to establish capital requirements for companies significantly engaged in insurance activities that have elected also to engage in the business of banking by operating a subsidiary bank or savings association. In particular, the 2014 Amendment expressly contemplates that the Board would establish minimum capital requirements for such companies.

<sup>28</sup> The Board used Monte Carlo simulation to translate the standard errors displayed in Table 2 of the white paper to a confidence interval for the calibration. In 95 percent of simulations, 8 percent total capitalization Risk Weighted Assets ratio translated to between 80 percent ACL RBC and 251 percent ACL RBC.

<sup>29</sup> Table 3 of the white paper parameterizes the scalars using alternative assumptions. These parameters can be used to translate 8 percent and 10.5 percent risk-weighted assets to NAIC RBC using the scaling formulas derived in Appendix 1.

diversification credit, or treatment of prescribed and permitted practices. While some of these differences may make the BBA more conservative than NAIC RBC, the differences provide for a consistent level of conservatism between the BBA and the banking capital rule and consistency between SIOs. For example, the Board’s capital rule applies to holding companies on a consolidated basis, including any unregulated entities. The BBA treatment of some non-depository institution, non-insurer subsidiaries of insurance BHCs and insurance SLHCs as MFEs and application of the banking capital rule to them does not justify reducing the BBA’s calibration to below the banking capital rule.

Additionally, even if the BBA were intended to match the stringency of NAIC RBC rather than the banking capital rule, many of the referenced details still would not justify reducing the BBA’s requirements. Senior debt does not qualify as capital for the issuer in either the BBA or NAIC RBC. If senior debt is downstreamed to a subsidiary as equity, it qualifies as capital for the subsidiary in both.<sup>30</sup> By design, NAIC RBC excludes the parent and other affiliated companies. The impact of these exclusions varies. If an unregulated entity is relatively well capitalized, including it would be *less* conservative than NAIC RBC. Similarly, prescribed and permitted practices could either increase or decrease surplus.

No changes were made regarding the interaction of the BBA and NAIC RBC or the operation of the capital conservation buffer. The BBA and NAIC RBC create separate requirements. SIOs must comply with all applicable legal requirements. The final rule, like the proposal, treats policyholder dividends as capital distributions. Policyholder dividends are how

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<sup>30</sup> Senior debt may qualify as capital for the issuer in the NAIC’s Group Capital Calculation (GCC). The BBA is, however, designed to match the stringency of requirements for other depository institution holding companies, not the GCC. The BBA and GCC also have different purposes. The GCC will be used as a tool by state insurance regulators, rather than a requirement. No GCC ratio would necessarily produce a similar intervention to a breach of the BBA’s minimum requirement.

mutual insurers distribute earnings to their owners. These capital distributions are analogous to shareholder dividends for stock companies. Prudent management requires limiting these payments when capital is low.

## **V. Determination of Building Blocks and Related Issues**

### **A. Inventory**

The proposed BBA calculation started by creating an inventory of the legal entities in a SIO, which generally would have been all legal entities under the depository institution holding company. This inventory would have served as the foundation for the BBA's aggregation.

As the proposal did elsewhere, it leveraged existing regulations to define the inventory. Under the proposal, a SIO's inventory would have included all entities that appear on organizational structure data reported to the Board or state insurance regulators.<sup>31</sup>

In rare cases, the inventory would have included a special purpose entity not included in the organizational structure data provided to the Board or filed with the state insurance regulators. The organizational data provided are generally based on control of a subsidiary, and therefore may not include all entities that the Board intends to include in the scope of the BBA in order to avoid missing risks. The burden of including such entities in the inventory would have been limited, as only special purpose entities with which an SIO enters into a derivative or reinsurance contract would have been included.

Under the proposed form FR Q-1, SIOs would have needed to report certain basic information (e.g., total assets) for all inventory companies. Two commenters suggested

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<sup>31</sup> The inventory would have contained any entity required to be reported under the Board's FR Y-6 or Y-10 reports or considered an affiliate under Statutory Statement of Accounting Principle (SSAP) 25 and reported on Schedule Y of the insurer's statutory annual report.

significantly reducing the reporting burden. The commenters asserted that SIOs could not easily calculate the total assets of subsidiaries multiple levels down their organization chart. To avoid this burden, these commenters argued for excluding immaterial, non-operating entities from the inventory.

One other commenter opposed including in the inventory any company that is not included in existing regulatory reporting. The commenter noted that determining whether a company needed to be included in the inventory would require estimating the company's expected losses, which would be difficult.

In response to the comments, the final form FR Q-1 requires less information than the proposal. Specifically, the final form FR Q-1 does not require reporting the assets and liabilities of inventory companies whose parents represent less than one percent of the group's assets. Based on QIS data, this form FR Q-1 change reduces the BBA's burden similarly to the inventory change suggested by two commenters.

In light of this change to the reporting form FR Q-1, the final rule does not alter the scope of the inventory in determining the scope in the BBA. For each inventory company, the final rule still requires checking whether the company should become a building block parent, but it would not require the asset and liability information from all inventory companies. The tests for becoming a building block parent, which are examined in the next section, focus on whether the BBA appropriately captures the company's risks. The final rule applies these tests broadly to avoid excluding material risks.

## **B. Identifying Capital Frameworks for Each Inventory Company**

After the creation of the inventory, the proposal would have identified each inventory company's applicable capital framework, which would have been used to partition the inventory

companies into building blocks. For insurance companies, the applicable capital framework would have been their current regulatory framework, except in rare cases.<sup>32</sup> For all other companies, the applicable capital framework would have been the Board’s capital rule or, the capital rule applied by the Federal Deposit Insurance Corporation (FDIC), or the capital rule applied by the Office of the Comptroller of the Currency (OCC).

Commenters generally did not oppose the rules for assigning companies to capital frameworks, but several QIS participants expressed confusion that the proposal would not actually have applied the “applicable capital framework” in all instances.<sup>33</sup> For instance, the applicable capital framework for non-insurance subsidiaries of insurers would have been the Board’s capital rule. However, most such companies would have remained in their insurance parent’s building block. This insurance parent would continue to assess the inventory companies’ risks using its insurance capital framework, unless they are an MFE.

To address this comment, the final rule replaces the term “applicable capital framework” with “indicated capital framework.” This revised terminology better describes the BBA’s usage. The indicated capital framework is the capital framework that would apply to a company if it were determined to be a building block parent.

### **C. Identification of Building Block Parents**

After identifying an applicable capital framework for each inventory company, the proposal would have identified building block parents (BBPs). Under the proposal, a building

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<sup>32</sup> Examples of rare cases would have included title insurers and non-scalar compatible insurers.

<sup>33</sup> Some commenters criticized the proposed application of the banking capital rule to companies other than banks. The root disagreement from these commenters appeared to be with the scoping and grouping rules rather than the identification of the banking capital rule as the indicated capital framework for companies not engaged in insurance. The commenters preferred to either exclude the companies from the BBA or analyze these companies together with their parents rather than specifying an alternative capital framework for analysis.

block parent could have been one of several different types of companies. The first would have been the top-tier depository institution holding company. In the absence of any other identified building block parents, the top-tier depository institution holding company's building block would have contained all of the top-tier depository institution holding company's subsidiaries. A second type of building block parent would have been a mid-tier holding company that is a "depository institution holding company" under U.S. law. The proposed treatment of these companies as building block parents would have allowed for the calculation of a separate BBA ratio at the level of these companies in the enterprise and helped to ensure that these companies remain appropriately capitalized.

The proposal would have identified additional building block parents based on grouping rules that would have generally relied on existing capital regulations. Relying on these frameworks materially reduces burden and the potential for unintended consequences. Additionally, the proposal would have identified certain other financial entities that are material to the group as building block parents. The proposal deemed these entities as MFEs, which are described below.

The proposal would have determined which entities are building block parents by considering whether the capital framework applicable to each inventory company or MFE is the same as that of the next-upstream company that is directly subject to a capital framework. Generally, the proposal would have had companies subject to the same capital framework remain in the same building block, except for one case. This exceptional case would have been where a company's applicable capital framework treats the company's subsidiaries in a way that does not substantially reflect the subsidiary's risk. For instance, there could be situations in which NAIC RBC may not fully reflect the risks in certain subsidiaries (typically, certain foreign subsidiaries)

that assume risk from affiliates.<sup>34</sup> In such cases, the subsidiary (which could be a capital-regulated company or MFEs) would have been identified as a building block parent so that its risks could more appropriately be reflected in the BBA.

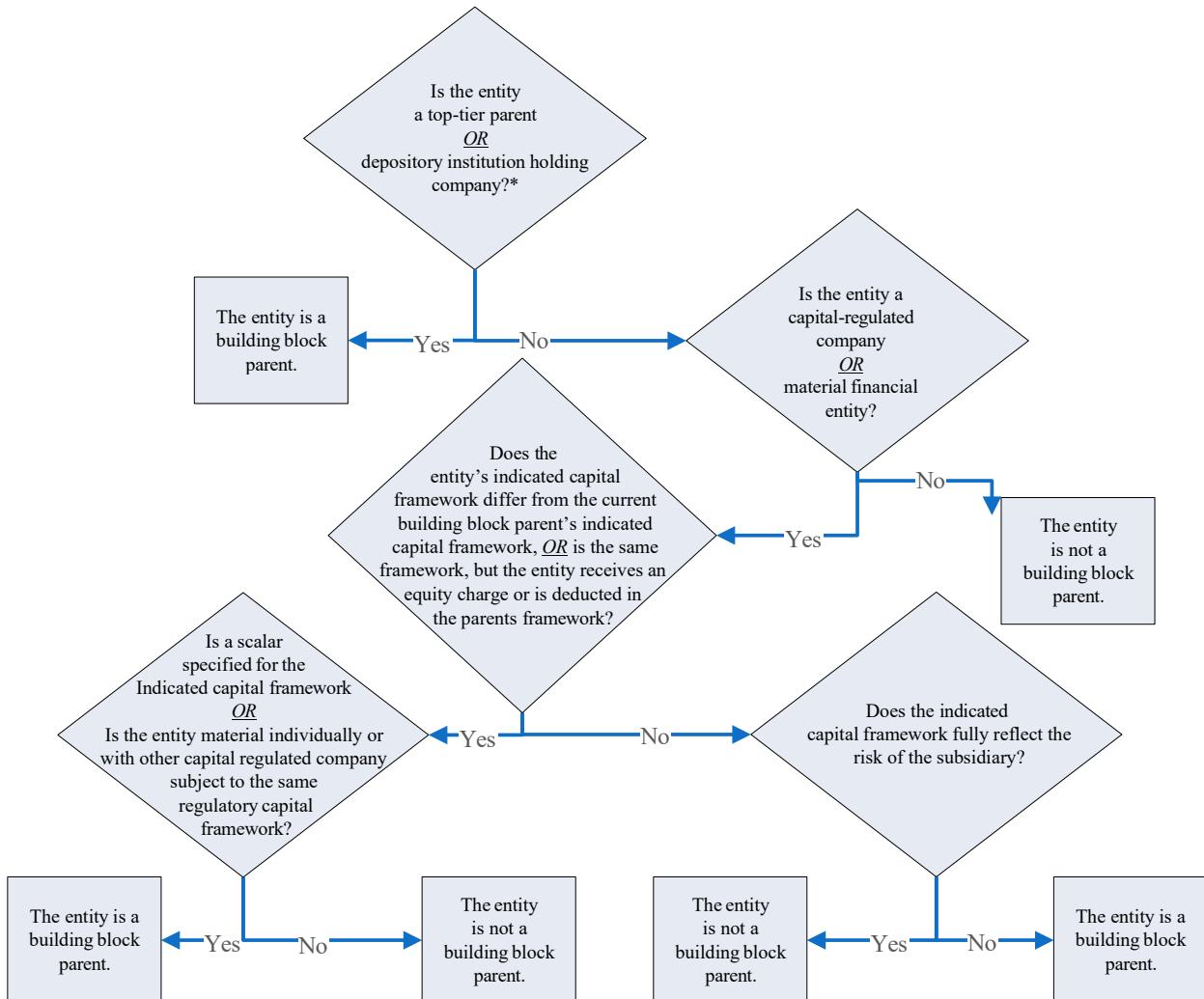
The proposal would have taken into account the risks of companies that are not building block parents indirectly through a building block parent's capital calculation using its regulatory requirements. This could have been through consolidation by a building block parent or accounting for the inventory company as an investment by the building block parent.

Figure 1 illustrates the how the rules for identifying building block parents would have worked under the proposal.

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<sup>34</sup> The BBA proposes to apply NAIC RBC to such subsidiaries. However, under state laws, the application of NAIC RBC on the parent would not normally operate to include the available and required capital from applying NAIC RBC to the subsidiary. However, when the subsidiary is identified as a building block parent in the BBA, the subsidiary's available and required capital under NAIC RBC would be reflected by the parent after aggregation.

Figure 1. Building Block Parent Identification



#### D. Material Financial Entity

A key step in the proposal's identification of building block parents would have been assessing whether a financial entity is an MFE. If an entity was determined to be a MFE in the proposal, it would have become a building block parent and assessed under either the banking capital rule or NAIC RBC. The proposal would have defined a financial entity as material if the top-tier depository institution holding company's total exposure to it exceeds 1 percent of the top-tier depository institution holding company's consolidated assets. While a parent company's exposure to a subsidiary most commonly arises from potential losses on the parent company's

investment, the exposure could also result from guarantees and other sources. In addition to this quantitative materiality definition, the proposed rule would have included a qualitative definition to capture entities that are otherwise significant when assessing capital. The proposal would have excluded certain entities, including some asset managers, from the MFE definition. The proposal would have also contained an option of electing to treat certain pass-through entities as MFEs or including their risks in the capital calculation of other building block parents. Typically, such a company would be one that serves as a pass-through or risk management intermediary for other companies under the insurance depository institution holding company.<sup>35</sup> If an insurance depository institution holding company were to make this election, the risks posed by this company would nonetheless have been reflected in the BBA. As proposed, the BBA would have required the insurance depository institution holding company to allocate the risks that the company faces to the other companies in the enterprise with which the company engages in transactions.

Commenters expressed diverging views on the concept of MFEs. Several commenters criticized some results of identifying MFEs as building block parents. These commenters noted the burden and complexity of applying the banking capital rule to non-banking companies. One commenter noted that this would be particularly problematic in the case of investment subsidiaries, as it would create burden and result in a misalignment with how an entity is treated in its parent's capital regime. This commenter believed these entities should be assessed along with the insurance company.

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<sup>35</sup> Frequently a pass-through company enters into transactions with affiliates (e.g., operating insurers) and enters into back-to-back transactions with third parties to manage risks on a portfolio basis.

Other commenters either explicitly agreed with the proposal or suggested only minor revisions. Commenters suggested that the threshold of 1 percent of total assets should be higher. One commenter argued that using total assets as the base measure for materiality is inconsistent with state-based insurance regulations, where surplus is most often used. Additionally, a commenter asserted that using total assets could penalize property and casualty (P&C) insurers relative to life insurers because P&C insurers are generally less leveraged. Another commenter suggested clarifying aspects of the definition of materiality, particularly with regards to captive insurers who may not use NAIC Statutory Accounting Practices. One commenter suggested considering size, off-balance sheet exposures, and activities involving derivatives or securitizations within the materiality definition.

Consistent with the proposal, the final rule continues to designate MFEs as building block parents when certain conditions are met. The Board intends the BBA to capture all material risks within the group. Designating MFEs as building block parents is essential to ensuring that these risks are appropriately reflected. Without this designation, SIOs could easily evade and manipulate BBA results by transferring risks from regulated entities to unregulated entities that would only be captured in the BBA through inclusion in their parent's capital requirement based on an equity risk factor applied to their net equity, which could result in a very small capital requirement if the entity is thinly capitalized. Based on the QIS results, identifying MFEs as building block parents will result in only minimal burden, but could have a significant impact in reducing the potential for regulatory arbitrage. All SIOs collectively identified only a very small number of MFEs in the QIS.

The final rule does, however, modify the definition of materiality in response to the comments. The final rule uses a threshold of 5 percent of equity of the top-tier depository institution's holding company rather than 1 percent of its assets. Because the BBA assesses

capitalization, capital represents a better benchmark for materiality than assets, and 5 percent better aligns with the thresholds used in other contexts (e.g., accounting). By assessing the materiality of exposure from all sources (e.g., investments and guarantees), the BBA's assessment of materiality incorporates the factors suggested by one commenter (e.g., off-balance sheet exposures).

The Board does not agree that designating an investment subsidiary as an MFE is problematic, as the proposal contained an exclusion that would have allowed pass-through treatment of the risk of the entity rather than treating it as an MFE. In addition, QIS results indicated this exclusion will operate as intended. The final rule does not change this treatment.

Based on the QIS, the final rule also makes a small change to address inventory companies that have no upstream entity and that are not a top-tier SLHC (e.g., a mutual insurance company controlled through common management). The NPR did not contemplate these types of companies. The final rule clarifies that if a company is an MFE or a company subject to capital regulation, then it must be considered a building block parent. These companies are exempted from the typical tests comparing their indicated capital framework to their upstream building block parent's indicated capital framework.

#### **E. Treatment of Asset Managers**

The proposal would have excluded certain asset managers from the MFE definition. Asset managers owned by insurers would have been assessed as they currently are in their insurance parent's risk-based capital calculation based on NAIC RBC. Asset managers owned by companies assessed using the Board's banking capital rule would have been consolidated by their parent company.

Commenters were divided on this exclusion from the MFE definition. Several commenters supported the exclusion and noted that the Board’s banking capital rule would not necessarily be more appropriate than the treatment of these subsidiaries under NAIC RBC. One commenter supported expanding the exclusion to also cover any activity that could be undertaken by a financial subsidiary. This commenter argued that other financial subsidiaries and asset managers should have the same treatment. This commenter also noted that the NPR specifically excluded financial subsidiaries of banks from the MFE definition through a different exclusion. Another commenter suggested further assessing the risks presented by different types of asset managers and varying the treatment of asset managers accordingly. Conversely, several other commenters did not support the exclusion. The commenters noted that due to the proposed exclusion, the treatment of material asset managers would have depended on the organizational structure of the SIO, and they argued that the BBA should seek to neutralize this discrepancy.

Commenters also disagreed on the best framework for assessing asset managers. Two commenters supported application of the banking capital rule to these companies. Other commenters supported broader application of NAIC RBC to asset managers. One commenter suggested an alternative approach based on GAAP for a subset of asset managers.

The final rule eliminates the exclusion of asset managers from the MFE definition so that all asset managers would be treated consistently under the Board’s banking capital rule. Consistent with the proposal, financial subsidiaries of banks are excluded from MFE definition because federal banking law requires deduction of these values from a bank’s capital.<sup>36</sup>

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<sup>36</sup> See 12 U.S.C. 24a(c).

## VI. Adjustments

### A. Capital Instruments

The proposal would have required certain adjustments at the level of determining building block available capital that would have included deducting any capital instrument issued by a company within the building block, that fails one or more of the eleven criteria for tier 2 capital under the Board's banking capital rule.<sup>37</sup>

For consistency with the Board's banking capital rule, senior debt would not have been considered as available capital. As noted above, many commenters expressed a view that senior debt should be included as qualifying capital, as it is structurally subordinated to policyholder liabilities and is similar to surplus notes in that regard. The Board's Insurance Policy Advisory Committee disagreed with these respondents and recommended the Board adopt the proposed capital instrument qualification without modification.

The proposal would have allowed surplus notes to be eligible for inclusion in tier 2 available capital under the BBA, provided that the notes meet the criteria. Recognizing that not all surplus notes previously issued would have addressed all of the tier 2 qualifying capital criteria, the proposal also including a legacy provision that allows surplus notes to qualify if issued by a top-tier depository institution holding company or its subsidiary to a non-affiliate prior to November 1, 2019. Commenters indicated that surplus notes should be included as tier 1 qualifying capital and if they only qualified as tier 2 capital, the proposed 62.5 percent limitation on the amount of tier 2 capital that can be counted toward an SIO's capital requirement should be higher.

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<sup>37</sup> The criteria are listed in § 217.608(a) of this rule. In the banking capital rule, they are codified at 12 CFR 217.20(d).

The proposal also would have limited, at the level of building block available capital for the top-tier parent, tier 2 capital instruments to be no more than 62.5 percent of the building block capital requirement for that top-tier parent. Commenters observed that statutory accounting is more conservative than GAAP, and this conservatism reduces the value of common equity tier 1 capital, but not the value of tier 2 capital instruments. This, in commenters' view, distorts the ratio of tier 2 capital instruments to common equity tier 1 capital, which the NPR would have used to limit tier 2 capital instruments.

The Board considered the comments and decided to maintain consistency with the Board's banking capital rule for both surplus notes and senior debt. This would require insurers to issue surplus notes meeting all of the Board's criteria consistent with the banking capital rule to qualify as tier 1 capital. For surplus notes that only qualify as tier 2 capital instruments, the Board did change the tier 2 limit as noted above. This also results in senior debt not being considered as qualifying capital. The Board recognizes the structural subordination argument; however, this argument applies to the insurance subsidiaries and not the regulated holding company, which does not benefit from structural subordination. The Board also recognizes that there are some similarities between surplus notes and senior debt, but unlike surplus notes, a default is triggered for non-payment of senior debt, which would impact the entire group.

Although the Board has decided to maintain consistency with the banking capital criteria, considering the impact of the conservatism of statutory accounting as expressed by the commenters, the final rule increases the tier 2 capital instrument limit to 150 percent of the building block capital requirement for the top-tier parent. In addition, in order to provide capital flexibility to firms, the Board added an additional tier 1 capital component as discussed above.

## **B. Adjustments for comparability**

The proposal included a series of adjustments to improve comparability among U.S. insurance entities. These adjustments including reversing permitted and prescribed practices, disallowing legacy treatment and transitional measures in the application of new capital regulation for insurers, and reversing certain transactions (e.g., captives) in order to ensure consistency between SIOs. While many aspects of insurance regulation have been harmonized across states, other aspects can differ significantly across companies and states.

The proposal would have used a consistent approach by assessing all U.S. insurers using NAIC RBC. Because NAIC RBC focuses on legal entities, it can be impacted by intercompany transactions. Some life insurers have used affiliated reinsurance transactions to alter their NAIC RBC ratios through the use of captives. These transactions move risks into captive reinsurance companies, which are generally not subject to the same accounting, disclosure, and capital requirements as NAIC RBC. The proposal would have neutralized much of the impact of these transactions through its grouping rules, which would have resulted in these affiliated reinsurance companies being analyzed using the same capital framework applicable to the ceding insurer.

The proposal would have gone further to provide consistent treatment by mandating the use of the accounting principles promulgated by the NAIC. States can and do deviate from the framework. States can either mandate that regulated companies do or do not recognize certain financial transactions or can require a measurement basis other than that promulgated by the NAIC (“prescribed practices”) or allow differences in recognition or measurement for a specific transaction (“permitted practices”). These practices can decrease the capital requirements for insurers. For instance, one of the contributing factors in the use of life insurance captives was that some states allowed a permitted practice whereby life insurers could transfer certain life

insurance business to a captive that would use a different accounting. This was due to the belief that some of the life insurance reserving requirements in NAIC RBC were overly conservative, and the captives were able to apply recognition and measurement concepts that were viewed as more appropriate. In moving the business to a captive, the life insurance entities could receive significant capital relief.<sup>38</sup>

The proposed rule included adjustments to address permitted practices, prescribed practices, or other practices, including legal, regulatory, or accounting, that departs from a capital framework as promulgated for application in a jurisdiction. The proposed rule would have adjusted capital requirements (the denominator in the BBA ratio) to reverse state permitted and prescribed practices (and, where relevant, any approved variations applied by solvency regulators other than U.S. state and territory insurance supervisors). The proposed adjustment was meant to provide for a consistent representation of financial information across all companies in the jurisdiction.

The proposal also would have removed all legacy treatment and transitional measures associated with changes in a capital regime, unless the measures were approved by the Board.<sup>39</sup> Transitional provisions and legacy treatment are utilized to make adoption of significant changes less burdensome for insurers, but can result in differences in application between insurers. An example of this, described above, is the change to PBR by the NAIC and states. Many states required insurers to apply PBR prospectively to new business beginning in 2020. This was optional in most states beginning in 2017. Due to the long-term nature of insurance liabilities,

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<sup>38</sup> Matthew Walker and Li Cheng, CFA, FRM, FSA, Page 2, Standard and Poor's Rating Services, Peaking =Inside the Black Boxes: Why North American Life Insurers are Using Captives and Why it Matters, May 12, 2015.

<sup>39</sup> Because the Board has approved all transitional measures within the banking capital rule, this adjustment would have only affected insurance transitional measures.

the measurement basis of most insurance liabilities by volume will continue to be the previous rules for many years. The proposal would have accelerated the transition by removing transitional measures not approved by the Board, which would have required applying PBR to legacy business (i.e., all business prior to 2020).

Commenters expressed divergent views that generally split into two high-level positions. One group of commenters argued against the proposed adjustments to increase consistency. Another group of commenters supported the adjustments but suggested simplifying certain aspects of the proposal to reduce burden.

Most commenters argued against making any of the suggested insurance adjustments. Several commenters argued that state prescribed and permitted accounting practices aren't motivated by arbitrage. For example, a company may not update its accounting practices after previously ambiguous rules are clarified differently. One commenter linked these practices to a broader issue of supervisory or jurisdictional discretion, which also exists in other frameworks such as Europe's Solvency II, and argued that these should all be recognized by the BBA. Several commenters argued that state prescribed and permitted practices can more faithfully represent idiosyncratic situations than the broad, default accounting rules. In these situations, the commenters argued that the proposed adjustments may *decrease* comparability. Similarly, commenters asserted that retroactively applying PBR could harm comparability because of differences in assumptions and interpretations. Several commenters also argued that these adjustments could confuse external stakeholders and management by causing the BBA to diverge from operating company RBC ratios. Commenters also stated that applying PBR retroactively would be burdensome. A large number of commenters argued that the Board should defer to the states on this topic. One of these commenters argued that failing to do so jeopardizes financial stability. Other commenters argued for further study, either of existing permitted and practices

or state regulations, which one commenter believed would indicate that these adjustments are not needed.

Several commenters supported the proposed adjustments with suggested modifications to reduce burden. These commenters asserted that individual state's permitted and prescribed practices can be justified, but they do harm comparability in aggregate. By volume, most state permitted and prescribed practices do not address idiosyncratic issues. Instead, they specify different substantive treatments on common issues. These commenters argued that the treatment of business should not depend on the state of the insurer or the cession of business to an affiliated reinsurance company.

The commenters, however, did suggest simplifying and clarifying the proposed insurance adjustments. Commenters wanted clarity on the scope of the adjustment on transitional measures and suggested that it may have unintended consequences by reversing transition measures related to the current expected credit losses methodology for estimating allowances for credit losses or requiring the restatement of insurance business using old mortality tables. With regard to PBR, commenters requested clarity on which types and years of business would require revaluation. Many commenters suggested simplifying or narrowing the scope of PBR revaluation. Approaches suggested included an approximation of a full PBR calculation by applying factors to current reserves, allowing the use of GAAP reserves instead, and allowing companies without captives or material exposures to opt out. Because PBR will apply prospectively, commenters suggested that these simplifications would better balance costs and benefits. One commenter also suggested retaining flexibility to maintain any given permitted or prescribed practice.

The final rule simplifies but does not eliminate the proposed adjustments that increase comparability. Comparing institutions helps the Board identify unsafe and unsound conditions and could also benefit other users of the BBA. These adjustments effectively harmonize the

approaches of different states to the approach set collectively through the NAIC. This aligns with other parts of the BBA. The BBA uses NAIC RBC, not the approach of any particular state, as the common capital framework. These adjustments convert individual company financial statements to that basis and justify not requiring any scaling between states. The final rule also includes the flexibility to allow any particular accounting practices if merited through the broad reservations of authority.

In place of the proposal’s reversal of transitional measures that have not otherwise been approved by the Board, the final rule adopts the factor-based simplification for PBR suggested by some commenters. The final rule specifies factors that will be applied to current statutory reserves for certain types of insurance business that are subject to legacy treatment under the NAIC rule, to approximate PBR reserves.<sup>40</sup> This narrower treatment of transitional measures eliminates any unintended effects on domestic insurance business. While the Board may eventually decide to reverse certain transitional measures in foreign insurance systems, these issues are currently not material to the Board’s supervised population.

### **C. Title Insurance Issues**

The proposal would have assessed title insurers using the banking capital framework because title insurers currently lack risk-based capital rules. To capture the risk of title insurance businesses, an additional 300 percent risk weight would have been applied to title insurance reserves. Additionally, title plants, which are collections of data and records related to the titles

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<sup>40</sup> A 40 percent factor is applied to all term life insurance business accounted for using an approach based on the Valuation of Life Insurance Policies Model Regulation (Regulation XXX). A 90 percent factor is applied to all secondary-guaranteed universal life insurance products accounted for using Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model (AXXX).

of real property, would have been deducted from available capital like other intangible assets in the banking capital framework.

The Board received two comment letters on the treatment of title insurance. These commenters did not oppose using the banking capital rule to assess title insurance business. However, they suggested modifying the treatment of title insurance reserves and title plant assets. They argued that title insurance reserves should qualify as tier 2 capital, that the 300 percent risk weight for title insurance reserves was too high, and that title plant assets should not be deducted from capital.

### **Title Insurance Reserves**

Commenters advocated including title insurance reserves in tier 2 capital and not applying a risk weight for two reasons. First, they argued this would be more consistent with the banking capital rule because title insurance reserves are analogous to banks' provisions for credit losses. Banks may count these allowances as tier 2 capital, subject to a limit of 1.25 percent of risk weighted assets. Second, commenters argued this would encourage conservative reserving.

The commenters also argued that the proposed 300 percent risk weight for title insurance reserves was inappropriately high. They claimed title insurance reserves are less risky than publicly traded equities based on a comparison of industry-wide title insurance reserves and returns of equity indices. They also argued that title insurance policies and underwriting standards have evolved since the financial crisis to make the industry less risky.

Based on an analysis of the comment letter and data, the final rule maintains the proposed treatment of title insurance reserves. Insurance reserves are substantively and significantly different than banks' allowances. Allowances are a contra-asset that reflect expected future reductions in asset cashflows; title insurance reserves are a liability which represents expected

future cash outflows. The reserves on other insurance products are a better analogy. Insurance capital frameworks unanimously classify insurance reserves as liabilities rather than capital. Indeed, many insurance capital frameworks, including NAIC RBC, explicitly use very conservative reserving methodologies to safeguard even more funds as liabilities. Commenters argued that this treatment incentivizes underestimating reserves; however, there are actuarial standards of practice that are followed by the vast majority of actuaries when developing reserves estimates. Additionally, applying a factor to a liability value is consistent with many other insurance capital regimes. Independent of the BBA, reserves impact earnings, taxes, executive compensation, and strategic business decisions. Some members of management can have a short-term incentive to reduce reserves to increase earnings, but internal controls help to protect against this risk. Fear about these controls failing, which would result in some reserves becoming capital, does not justify treating reserves like capital.

The final rule maintains the 300 percent factor for title insurance reserves. During the financial crisis, the four largest title insurers' reserves varied significantly more than equity indices. While the financial crisis hit title insurers particularly hard, the percentage losses on these reserves also exceeded the equity losses in *any* period, including the Great Depression. One of the four largest title insurers became insolvent. Another's reserves more than doubled. A third's reserves increased by more than 50 percent. The industry-wide data from commenters underestimate the potential volatility for individual companies. Data since 2011 on all title insurers show that 10 percent reserve increases are somewhat common even when industry-wide reserves are relatively stable.

## **Title Plant Assets**

Commenters also argued that title plant assets, which are collections of data and records related to the titles of real property, should not be deducted from capital and should instead receive a risk weight of 100 percent. They stated that title plant ownership interests are readily transferable. Insurers and agents often transfer ownership interests in title plants, which can be done without selling a business. The commenters believed these transactions could be completed even under adverse financial conditions.

The final rule deducts title plant assets from capital. During a stress event, title plant assets would likely not be capable of generating significant resources. The most likely buyers for an asset which helps underwrite title insurance would be a title insurer. But if one large title insurer needs capital, others are likely to require capital as well. Even if a potentially willing and able buyer were found, the transaction could face other difficulties, including antitrust scrutiny. The title insurance industry is highly concentrated. An attempted merger of two large title insurers in 2019 was abandoned after the Federal Trade Commission opposition on antitrust grounds.<sup>41</sup>

## **VII. Scaling**

Scaling was considered in the proposal because regulatory capital frameworks differ in their outputs. While these outputs all assess capital, some use radically different terminology and scales. Banking capital frameworks focus on of risk weighted asset ratios, with requirements set at levels well below 100 percent. Insurance capital frameworks, in contrast, are set based on

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<sup>41</sup> Fidelity National Financial, Inc. Form 8-K Termination of Material Definitive Agreement, Filed September 11, 2019 [Fidelity National Financial, Inc. Form 8-K](#)

multiples of state requirements and target ratios well above 100 percent. Aggregating these different metrics requires translating (that is, “scaling”) them.

Because of scaling’s importance to the BBA, the Board published a white paper<sup>42</sup> on it. The white paper explored scaling and assessed different potential scaling methods. On the basis of the white paper’s assessment, the proposal would have based scaling between the Board’s banking capital rules and NAIC RBC based on historical default probabilities. The proposed method used these default rates as a benchmark for translation. The white paper’s analysis indicated this results in the most accurate translation of any method. Accurate translations facilitate aggregation and ultimately the assessment of an institution’s safety and soundness.

The proposal did not propose scalars for other jurisdictional regimes at this time primarily due to a lack of consistent default information. Instead, the proposal included a provisional scaling method that would have applied in the absence of specified scalars. This method assumed the equivalence of available capital calculations and regulatory intervention points after an adjustment for country risk.

Commenters largely agreed with the Board’s analysis. Several commenters explicitly supported the Board’s proposed approach. These commenters said the approach was thoughtful, rigorous, and practical. No commenter explicitly disagreed with using it to translate between NAIC RBC and the federal banking capital rule. One commenter, did, however raise concerns that the proposed approach was “bank centric” and overly dependent on default data from P&C insurance groups, which may differ from data from other types of insurers.

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<sup>42</sup> *Comparing Capital Requirements in Different Regulatory Frameworks*, September 2019, <https://www.federalreserve.gov/news-events/pressreleases/files/bcreg20190906a1.pdf>.

The main criticism of the Board’s overall scaling proposal was that it supplies scalars only between two capital frameworks as described above. Several commenters asked the Board to specify scalars for other frameworks rather than relying on this provisional scaling method. They argued that this would reduce uncertainty and aid international negotiations. Because of the lack of default data on other frameworks, these commenters also encouraged the Board to develop practical alternatives to relying on default data. In addition to the comments on developing scalars for other jurisdictions, the Board also received comments on the provisional scaling method. One commenter argued that this country risk adjustment disfavors international frameworks relative to the U.S. framework. Another commenter disagreed with some of the discussion in the white paper of the provisional methodology and argued that it did not adequately consider the possibility of interpolating a scaling methodology from a single assumed equivalency point or the possibility of using multiyear analysis to mitigate volatility. Another commenter thought the proposed provisional scaling method was not as sophisticated as what the NAIC is considering as part of its group capital calculation. Those methods rely on an alternative assumption related to the different insurance industries being equally well capitalized.

After reviewing these comments, the Board is finalizing scalars between NAIC RBC and the Board’s banking capital rule as proposed. As explained in the white paper, historical insolvency rates are a fair benchmark for solvency ratios from different frameworks, and the Board’s testing did not indicate a bias toward either banks or insurers. Extensive data exists on banks, P&C insurers, and life insurers. This data did not support treating the life and P&C capital frameworks differently.<sup>43</sup>

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<sup>43</sup> When parameterized separately, life and P&C insurance frameworks generated nearly identical scalars. A t-test regarding the differences in these parameters resulted in a p-value close to 50 percent. See page 18 of the White Paper for further information.

The Board considered and attempted to survey all potential scaling methods in the published white paper. The Board’s analysis revealed a trade-off in scaling methods between the reasonableness of their assumptions and the amount of data they required. Without data, scaling requires using untested assumptions. No comment disputed this trade-off.

Because more accurate scaling requires data and data is limited on many frameworks, the Board could either vary its approach based on the data available or exclusively use a framework that would rely on data that is more likely to be available but would not provide scaling results to sufficient degree of accuracy. The final rule, like the proposal, avoids setting a uniform approach to scaling. This does create some uncertainty about how foreign insurance frameworks would be treated, but it also allows more accurate translations domestically. To reduce the uncertainty, the Board will continue working with the NAIC domestically, and at the IAIS internationally, on scaling, including parameterizing scalars within the BBA as appropriate.

The final rule also adopts the provisional scaling methodology as proposed for material foreign insurance entities. Other approaches may produce more accurate translations, but they also require more data. A provisional scaling method must always output a valid translation. Without this, a SIO would not be able to compute its BBA ratio in the absence of a further Board rulemaking or order. The proposed methodology requires the least amount of data. Additionally, the NAIC is currently using an unscaled approach in its development of the GCC, which, like the provisional approach, would leverage the capital requirements in jurisdictions with risk-based regimes, though it does not include a country risk adjustment. The final rule maintains this adjustment as country risk affects the insurers operating in those jurisdictions. With regard to the technical points made, the Board believes these were accurately discussed in the white paper.

One commenter noted that changes to NAIC RBC could impact scalars and asked about the timeframe for updates to the scalars and their effect time. The Board will monitor changes to NAIC RBC and plans to update scalars as necessary rather than on a predetermined schedule. Proposed updates to the scalars will be released for public comment prior to adoption.

### **VIII. Aggregation**

The proposal would have aggregated the adjusted and scaled output from the building block parents. At each level of aggregation, the scaled and adjusted results from subsidiary building block parents would have replaced the default treatment for these risks in the indicated capital framework of the upstream building block parent. For example, an insurance company that owns a depository institution would have held this depository institution on its balance sheet based on GAAP equity and applied a factor to this value to calculate the capital required on the investment. When calculating available capital, the proposal would have replaced the GAAP equity with the bank's scaled capital, as calculated under the proposed BBA. Similarly, scaled and adjusted output from the bank capital framework would have replaced the insurance capital framework's treatment of the bank subsidiary.

The proposal would have used proportional consolidation to address the partial ownership of building block parents. When aggregating the risks of a downstream building block parent, the upstream building block parent would have only included a fraction of the downstream parent that is proportional to its ownership. In the proposal, this proportion would have been based on the fraction of the capital resources of the downstream building block parent owned by the upstream building block parent.

The Board received one comment regarding this aspect of the proposal. The commenter suggested using the proportion of equity in place of the proportion of capital to allocate ownership of an inventory company among multiple building block parents.

As suggested by the commenter, the final rule uses equity ownership percentages to incorporate partially owned building block parents. This fraction is calculated for other purposes and would simplify the rule without materially impacting the calculation of the BBA ratio.<sup>44</sup> The final rule otherwise adopts the proposed method of aggregation under the BBA.

## **IX. Reporting**

To implement the BBA, the Board proposed a new reporting form. This reporting form, form FR Q-1 would have collected information needed to carry out the BBA calculations.<sup>45</sup> Form FR Q-1 would have facilitated monitoring the capital position of companies subject to the BBA.

The Board published a proposed version of form FR Q-1 for comment along with the NPR. This proposed reporting form served as the basis for a voluntary QIS from SIOs. Several comment letters addressed form FR Q-1. Additionally, QIS participants provided feedback based on their experience completing the form.

Several issues raised in the context of form FR Q-1 overlap with other aspects of the BBA and are discussed elsewhere in this Supplementary Information section. As discussed above in Section II related to the BBA's effective date, several comments requested deferring the

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<sup>44</sup> A top-tier depository institution holding company's BBA ratio would be impacted by this change only if (1) a subsidiary building block parent issued capital outside of the group, (2) the subsidiary building block parent issued both equity and non-equity capital instruments, and (3) the group's ownership percentage of the non-equity capital instruments differed from its ownership of equity capital instruments.

<sup>45</sup> The adopted form FR Q-1 and instructions are available at <https://www.federalreserve.gov/apps/reportforms/review.aspx>.

first filing of form FR Q-1's attestation cover page to avoid requiring controls related to the BBA to be in place before the BBA becomes effective. The final rule defers the first filing of the attestation cover page until the submission of the second form FR Q-1. As discussed in Section V.A related to the BBA's inventory, commenters suggested the Board restrict the definition of an inventory company to reduce form FR Q-1's burden. Instead, the adopted version of form FR Q-1 limits the inventory companies that are required to provide asset information to achieve a similar effect.

Commenters also raised issues regarding form FR Q-1's proposed March 15 yearly deadline, the amount of form FR Q-1 information that would be made public, and how much of the information related to form FR Q-1 would need to be audited.

#### **A. Submission Date**

The proposal would have had a March 15 annual submission deadline for form FR Q-1. This date was selected to closely follow the March 1 date on which state insurance legal entities must submit their annual statements to state insurance regulators. Because the BBA relies on information in these reports, form FR Q-1's deadline should occur after it. A date shortly after this deadline was proposed because timely information facilitates better supervision.

Commenters requested extending the submission deadline for form FR Q-1. These commenters cited the burden of an additional reporting form tied to the year-end. They suggested that form FR Q-1 be submitted further back in the queue of these reports. June 1 was the most common requested filing date, which would coincide with the date insurers must submit audited financial statements. Commenters noted the additional accuracy with these audited statements. Two other commenters suggested slightly earlier dates.

In response to the comments, the final rule includes a March 31 due date for form FR Q-

1. This allows SIOs an extra two weeks to complete the report in recognition of the report's reliance on U.S. statutory financial statements that are filed with the states, and the existing burden on reporting staff during this period of time. The final rule does not, however, extend the deadline as much as suggested by commenters. Doing so would significantly disrupt the Board's supervision schedule and mean that the most recent BBA information available would be between 5 and 17 months out of date. Conversely, for other banking organizations, significantly more detailed consolidated financial information is reported quarterly, around a month after the close of a quarter.

## **B. Public Disclosure**

Under the proposal, the vast majority of the information reported to the Board through the proposed reporting form FR Q-1 would not have been made public. The information that the Board proposed to make public would have consisted of the building block available capital, building block capital requirement, and BBA ratio for the top-tier parent of an insurance depository institution holding company's enterprise. This sought to protect some of the non-public information contained within form FR Q-1 while still providing the public some transparency into the capitalization of the firm, which could be used as the basis for supervisory actions. The proposed disclosure was significantly less extensive than the disclosure required for other financial institutions because of the Board's limited role in regulating supervised insurance institutions and the potential competitive effects of requiring disclosure from only a small subset of the sector.

Commenters expressed diverging opinions on the disclosure proposal. One commenter supported the proposal. Three other commenters argued that all aspects of the BBA should be

confidential. They argued that disclosing the BBA ratio could cause competitive disadvantages because the NAIC does not intend to make public the results of their group capital calculation.

The final rule adopts the proposed disclosure standard. The Board will publish each SIO's overall results along with their numerator and denominator. Although publishing detailed information on a supervised institution, some of which is contained in form FR Q-1, could cause competitive harm, publishing this overall BBA ratio and the numerator and denominator would not. No trade secret information can be derived from disclosing this high-level datum related to the overall enterprise's capitalization. Outside of revealing confidential information, the BBA ratio could place an SIO at a competitive disadvantage if the ratio itself could be used against the company. A very poor BBA ratio could be marketed against a company, but a very poor BBA ratio likely could not be kept a secret regardless because it results in supervisory consequences. For example, companies that breach the BBA's minimum requirements will face limitations on capital distributions that would be difficult to conceal. Additionally, it is likely that for any SIO with a low BBA ratio, there would be publicly available information indicating that some of the underlying building blocks are thinly capitalized through either the published banking capital ratios or the U.S. statutory filings. The net impact of the disclosure then relates to the exact amount of the BBA ratio, particularly when it is above the minimum. No commenter provided any plausible avenue for how this could be used to harm an SIO.

### **C. Audit Requirements**

The NPR was not clear about how much of the information entered into form FR Q-1 would need to be subject to an independent audit. However, it included a requirement that all BBA controls would be subject to an internal audit annually. The proposal would have mandated that building block parents calculate their available and required capital under their

indicated capital framework, but it did not specify whether the source financial statements should be audited. The bank rules referenced by the BBA do not clearly resolve the issue. There is no universal financial statement audit requirement, although FDIC regulations do require audited financial statements from depository institutions over a certain asset threshold, and this audit can be satisfied by an audit of the depository institution holding company.<sup>46</sup> Section 238.5 of the Board's Regulation MM also requires audited financial statements for SLHCs with greater than \$500 million in consolidated assets.<sup>47</sup>

Commenters argued that an independent audit of financial statements for each building block parent should not be required by the BBA or form FR Q-1 instructions. They argued this would be burdensome, without creating corresponding benefits. In relation to the proposed internal audit requirement, one commenter argued that the requirement would be overly burdensome and unnecessary on account of the requirement for a senior officer to attest to the accuracy of form FR Q-1 and existence of appropriate controls.

The final rule and form FR Q-1 instructions remove the proposed internal audit requirement and clarify the Board's expectations for independent audits of building block parent financial statements. While the final rule does not require Internal audit coverage of form FR Q-1 each year, the Senior Officer in signing form FR Q-1 must attest that related internal controls of the firm are considered adequate by Internal audit.

As noted above, the proposal did not include an explicit audit requirement for the underlying building blocks or for the enterprise, and the Board has not adopted one in the final rule. However, the safety and soundness considerations that justify the audit requirements of 12

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<sup>46</sup> 12 CFR 363.1.

<sup>47</sup> 12 CFR 238.5.

CFR 238.5 and in FDIC annual audit rules<sup>48</sup> apply to SIOs as well. Typically, the financial statements of large companies, particularly those with \$500 million or more in consolidated assets, should be subject to an audit performed by a qualified independent public accountant. This is particularly true of large building block parents, whose financial statements would typically be relied upon for this calculation and when making business decisions. As with the financial statements of depository institutions under the FDIC rule, this audit expectation could be fulfilled through an audit of a holding company's financial statements if the holding company consolidates the entity. In addition, U.S. statutory accounting requirements (rules) have audit requirements for most insurance legal entities. Between the banking requirements and the U.S. statutory requirements, it is expected that most of the building block parents will have audits. The Board will monitor implementation of the BBA and determine if there are audit gaps. If gaps are discovered, the Board would consider implementing an audit requirement by independent public accountants of financial statements of building block parents with total assets of \$500 million.

## **X. Economic Impact Analysis of the BBA**

The Board analyzed the potential costs and benefits of the proposed minimum risk-based capital requirements for supervised insurance holding companies. Setting the BBA at the similar stringency level as bank capital requirements minimizes the incentive for BHCs to acquire or sell insurance operations due to disparate capital requirements, while maintaining the safety and soundness of supervised firms. The Board analyzed whether the proposed level of the BBA requirements might drive currently supervised firms to shed their depository institutions or

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<sup>48</sup> See 12 CFR Part 363.

meaningful deter other insurers from acquiring thrifts, given that the BBA's total capital requirement would be higher than any current state requirements. Data from the BBA QIS, as of year-end 2018, indicated that none of the currently supervised insurance institutions would have needed to raise capital to comply with the rule. This was confirmed to still be the case as of year-end 2021 based on analysis of these firms' Statutory Insurance Annual Statements and data on depository institutions and intermediate holding companies.

This same data was used to assess the distribution of Risk Based Capital ratios relative to the BBA requirements for the universe of insurers with over \$1 billion in assets. Nearly nine in ten insurers could meet the 400 percent total requirement without raising capital and only 1 percent of insurers were below the proposed 250 percent minimum. This demonstrates that the vast majority of insurers would not be deterred by the BBA from acquiring thrifts by the BBA while appropriately excluding the least capitalized insurers from doing so.

Parallel to the capital required by the BBA calculation, insurance depository institution holding company would also have to demonstrate capital adequacy on a fully consolidated basis as prescribed by section 171 of the Dodd-Frank Act. An SIO may comply with this requirement on a fully consolidated basis using the bank capital requirements. Alternatively, an SIO may utilize the flexibility afforded by the 2014 Amendment to exclude certain state- and foreign-regulated insurance operations and to exempt top-tier insurance underwriting companies from the risk-based capital requirement. The final rule allows SIOs to utilize one of two different calculations that consider the section 171 calculation scope exceptions: full deduction from capital of investment in subsidiaries or risk weighting of these investments at 400 percent, consistent with the current treatment of bank's equity exposures. The Board's analysis confirms that for most mutual insurance companies, the parallel requirement would not be relevant. A significant percentage of publicly traded companies would likely fail to meet the requirement

based on the deduction option, though most could satisfy the risk-weight option. Overall, the parallel requirement would not have material impact due to the different options for achieving compliance.

The BBA framework is designed to protect subsidiary insured depository institutions from risks in the broader enterprise. The Board analyzed the experience of insurance depository institution holding companies during a significant stress period, the 2007-09 financial crisis, to shed light on the potential benefits of an enterprise-wide risk-based capital requirements. Prior to the financial crisis, more than twenty holding companies would have been subject to enterprise-wide capital requirements, had such a rule been in place, due to their significant engagement in insurance activities. These combined assets of these firms was over \$3.3 trillion, according to data from the FR-Y9C and OTS 1313 Thrift Financial Reports.

Depository institution subsidiaries tended to be a source of strength for these insurers when some of them suffered significant capital impairment at their non-banking subsidiaries. No depository institution affiliates of insurers were resolved by the FDIC during the 2007-09 financial crisis. Banking-insurance combinations also enabled some insurers to access emergency relief programs available to banks. Three of these insurers received public assistance aimed at bolstering their solvency, while six participated in Federal Reserve liquidity facilities and seven increased their reliance on public liquidity backstops. These included the largest three pre-crisis insurance depository institution holding companies and in aggregate accounted for about two-thirds of the total assets of this group.

Unlike regulations in place during the 2007-09 financial crisis, the BBA provides a clear regulatory capital framework for insurers that try to acquire depository institutions for the purposes of accessing emergency facilities. Had it been in place, the BBA could have either forced the insurers to raise capital before completing the transactions or prevented such

transactions due to a lack of consolidated capital. In such a context, the BBA could help protect taxpayer funds by ensuring the safety and soundness of insurers accessing emergency facilities via a depository institution acquisition, since the insurer would need to meet the BBA minimum requirement in order to do so. As such, the consolidated BBA may lessen moral hazard associated with the implicit government backstop seen in the financial crisis.

When the Federal Reserve assumed responsibility for supervision of insurance SLHCs in mid-2011 there were 28 such firms. Fairly rapidly, a majority of these firms left the Federal Reserve's regulatory purview, either by converting their depository subsidiaries to trust banks or by divesting from their thrifts entirely. These divestments could be troubling if it implied that potentially synergistic mergers have been discouraged. While it is difficult to precisely ascribe these dissolutions to any particular factors, the Board's analysis relied on financial comparisons and textual evidence to illuminate the likely causes.

A quantitative comparison was conducted, using data collected by the Office of Thrift Supervision leading up to the time of the handover of supervisory responsibility to the Board, between those firms keeping their depository institution subsidiaries and those that either converted their depository subsidiaries to trust banks or divested from their thrifts entirely. The firms that kept their thrift subsidiaries tended to have banking as a larger share of their overall business operations and to be more profitable. The firms that de-thrifited tended to be riskier as measured by leverage and the volatility of earnings.

Reviewing the record of banking-insurance combinations highlights three drivers of de-thrifting that are tangential to the BBA capital rule. First, most divestments preceded the development of the BBA. While some insurers did cite regulatory concerns as a factor in their decisions, they highlighted potential stress tests or distribution restrictions rather than capital standards. Second, the economies of scale envisioned from cross-selling banking and insurance

products failed to materialize. Finally, the small size of the thrifts at most insurance SLHCs suggest an additional headwind. Economies of scale from technological advances and the loosening of branching restrictions have long raised competitive difficulties for small depository institutions that are unrelated to any specific requirements of the BBA. It is clear from the analysis that the development of the BBA was not the driver of insurers divesting or switching charters. Further, the primary aim of the rule, protecting insured depository subsidiaries from risks in the broader enterprise, fits with the pattern of the riskiest firms divesting their banks while those who maintain them have banking as a major business line, are well capitalized, and operate at low risk levels.

The BBA capital rule is more stringent than state level insurance regulation in that it entails swifter regulatory intervention should capital deteriorate. The Board quantified this comparative stringency using data collected through the QIS for the firms in the Board's supervisory portfolio. Intervention probabilities over a three-year horizon were estimated based on how BBA ratios, projected back over the prior two decades, have compared against the required capital plus the buffer. Relative to a firm's respective state-level requirement, threshold breach probabilities were on average about four percentage points higher under the BBA, though this varied from near zero to over 10 percent. This demonstrates that the BBA capital rule is consistently more conservative than state-level requirements, enhancing protection of the insured depository subsidiaries. Regulatory interventions, to the extent they reduce the ability to do business or require additional compliance resources, can impose costs on firms. In practice, firms with higher intervention probabilities based on their current financials may raise their capital levels to forestall the need for regulatory intervention.

In addition to somewhat higher capital requirements, supervised insurance holding companies would also see two notable differences in how their capital levels are determined relative to state-level regulations, both of which are intended to enhance the quality of capital.

First, captive reinsurers are consolidated under the same accounting standards as U.S. operating insurance entities rather than being permitted to back some policy reserves with lower-quality assets. Such a treatment could put insurers covered by the BBA at a competitive disadvantage by necessitating higher premiums on certain products. The effect on currently supervised firms would be small given their limited use of captive reinsurance. The Board's calculations suggest about one-fifth of life insurers by assets industry-wide would not have sufficient capital to meet the BBA capital conservation buffer without the relief provided by captives, potentially deterring their interest in acquiring a depository institution. Because this form of capital relief derives from a corporate structure choice rather than actual risk differences, it would be counter to the principle that the same activity should get the same regulatory treatment.

Second, the share of insurer capital that can be accounted for by surplus notes is capped. While the NAIC considers these instruments as capital, they are a form of unsecured subordinated debt with fixed payment schedules. In principle, heavy users of surplus notes would be disincentivized from acquiring a depository institution given the need to raise more costly forms of capital. The impact in practice is expected to be minimal given the stipulation under the BBA legacy treatment of existing surplus notes as a qualifying capital instrument. Further, the Board's analysis found that the incremental difference in the share of firms industry-wide who would not meet the BBA's regulatory thresholds is not meaningfully different with the use of surplus notes capped.

## **XI. Administrative Law Matters**

### **A. Paperwork Reduction Act**

In connection with the final rule, the Board is implementing “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501-3521). In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number is 7100-NEW. The Board reviewed the final rule under the authority delegated to the Board by OMB.

In order to implement the final rule, the Board is implementing the FR Q-1 reporting form, which contains reporting requirements subject to the PRA. The reporting form has been implemented pursuant to section 171 of the Dodd-Frank Act and section 10 of HOLA for insurance depository institution holding companies. The Board received no comments specifically related to the PRA. The Board did receive two comments, as described above, relating to the difficulties of providing certain information for all subsidiaries. The Board lowered the reporting burden by adding a materiality threshold that will eliminate some of the reporting on immaterial inventory companies.

#### **Implementation of the Following Information Collection**

*Collection title:* Capital Requirements for Board-regulated Institutions Significantly Engaged in Insurance Activities.

*Collection identifier:* FR Q-1.

*OMB control number:* 7100-NEW.

*General description of report:* Section 171 of the Dodd-Frank Act requires, and section 10 of the HOLA authorizes, the Board to implement risk-based capital requirements for depository institution holding companies, including those that are significantly engaged in insurance activities.

*Frequency:* Annual.

*Affected Public:* Businesses or other for-profit.

*Respondents:* Insurance depository institution holding companies.

*Estimated number of respondents:* 5.

*Estimated average hours per response:* 175.50 for initial setup and 43.88 for ongoing compliance.

*Estimated annual burden hours:* 1,097 (878 for initial setup and 219 for ongoing compliance).

*Current Actions:* Pursuant to section 171 of the Dodd-Frank Act and section 10 of HOLA, the Board has adopted the application of risk-based capital requirements to certain depository institution holding companies. The Board has adopted an aggregation-based approach, the Building Block Approach, that would aggregate capital resources and capital requirements across the different legal entities under an insurance depository institution holding company to calculate consolidated, enterprise-wide qualifying and required capital. The BBA utilizes, to the greatest extent possible, capital frameworks already in place for the entities in the enterprise of a depository institution holding company significantly engaged in insurance activities and is tailored to the supervised firm's business model, capital structure, and risk profile. The new reporting form (FR Q-1) requires a depository institution holding company to produce certain information required for the application of the BBA. The reporting form and instructions are available on the Board's public website at

<https://www.federalreserve.gov/apps/reportingforms/home/review>.

The Board made several changes to form FR Q-1 and the FR Q-1 instructions that correspond with changes to the final rule. The changes include the addition of a new column for additional tier 1 capital, revising the tier 2 limit, the materiality calculation for reporting requirement on inventory companies, a simplification on how building blocks are aggregated, and the inclusion of a request for confidentiality check box. One additional change was made to include a column to list the Legal Entity Identifier for inventory companies, which allows for more consistent identification of legal entities. The changes in the aggregate are a reduction in the burden from the proposed FR Q-1. Form FR Q-1 is effective January 1, 2024.

## **B. Regulatory Flexibility Act**

An initial regulatory flexibility analysis was included in the proposal in accordance with section 603(a) of the Regulatory Flexibility Act (RFA).<sup>49</sup> In the initial regulatory flexibility analysis, the Board requested comment on the effect of the proposed rule on small entities and on any significant alternatives that would reduce regulatory burden on small entities. The Board did not receive any comments on the initial regulatory flexibility analysis. The RFA requires an agency to prepare a final regulatory flexibility analysis unless the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. Based on its analysis, and for the reasons stated below, the Board certifies that the rule will not have a significant economic impact on a substantial number of small entities.<sup>50</sup> In accordance with section 171 of the Dodd-Frank Act and section 10 of HOLA, the Board is adopting subpart J to 12 CFR part 217 (Regulation Q) to establish risk-based capital

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<sup>49</sup> 5 U.S.C. 601 *et seq.*

<sup>50</sup> 5 U.S.C. 605(b).

requirements for insurance depository institution holding companies.<sup>51</sup> An insurance depository institution holding company's aggregate capital requirements generally are the sum of the capital requirements applicable to the top tier parent and certain subsidiaries of the insurance depository institution holding company, where the capital requirements for regulated financial subsidiaries are based on the regulatory capital rules of the subsidiaries' functional regulators—whether a state Department of Insurance or a foreign insurance regulator for insurance subsidiaries, or a Federal banking regulator for IDIs. The BBA then builds upon and aggregates capital resources and requirements across groups of legal entities in the insurance depository institution holding company's enterprise (insurance, non-insurance financial, non-financial, and holding company), subject to adjustments.

Under Small Business Administration (SBA) regulations, the finance and insurance sector includes direct life insurance carriers, direct title insurance carriers, and direct P&C insurance carriers, which generally are considered "small" for the purposes of the RFA if a life insurance carrier or title insurance carrier has average annual receipts of \$47 million or less or if a P&C insurance carrier has less than 1,500 employees.<sup>52</sup>

Life insurance companies and title insurance companies that are subject to the rule all substantially exceed the \$47 million average annual receipt threshold at which they would be considered a "small entity" under SBA regulations. P&C insurance companies subject to the rule exceed the less than 1,500 employee threshold below which a P&C entity is considered a "small entity" under SBA regulations.

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<sup>51</sup> See 12 U.S.C. 1467a and 5371.

<sup>52</sup> [13 CFR 121.201](#). Consistent with the SBA's General Principles of Affiliation, the Board includes the assets of all domestic and foreign affiliates toward the applicable size threshold when determining whether to classify a particular entity as a small entity. See 13 CFR 121.103.

Because the rule does not apply to any life insurance carrier or title insurance carrier with average annual receipts of less than \$47 million, or P&C carrier with less than 1,500 employees, it will not apply to a substantial number of small entities for purposes of the RFA. Accordingly, the Board does not expect the rule to have a significant economic impact on a substantial number of small entities.

### **C. Plain Language**

Section 722 of the Gramm-Leach-Bliley Act<sup>53</sup> requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board sought to present the proposal in a simple and straightforward manner and did not receive any comments on the use of plain language.

#### **List of Subjects**

#### *12 CFR Part 217*

Administrative practice and procedure; Banks, banking; Federal Reserve System; Holding companies; Investments; National banks; Reporting and recordkeeping requirements; Securities.

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<sup>53</sup> 12 U.S.C. 4809.

*12 CFR Part 238*

Administrative practice and procedure; Banks, banking; Federal Reserve System; Holding companies; Reporting and recordkeeping requirements; Securities.

*12 CFR Part 252*

Administrative practice and procedure; Banks, banking; Credit; Federal Reserve System; Holding companies; Investments; Qualified financial contracts; Reporting and recordkeeping requirements; Securities.

**Authority and Issuance**

For the reasons set forth in the preamble, the Board of Governors of the Federal Reserve System amends chapter II of title 12 of the Code of Federal Regulations as follows:

**PART 217 – CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)**

1. The authority citation for part 217 continues to read as follows:

**Authority:** 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–1, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5368, 5371, 5371 note, and sec. 4012, Pub. L. 116-136, 134 Stat. 281.

**Subpart A—General Provisions**

2. In § 217.1:

a. Revise paragraph (c)(1); and

b. Add paragraph (g).

The revision and addition read as follows:

**§ 217.1 Purpose, applicability, reservations of authority, and timing.**

\* \* \* \*

(c) \* \*

(1) (i) This part applies on a consolidated basis to every Board-regulated institution that is:

(A) A state member bank;

(B) A bank holding company domiciled in the United States that is not subject to 12 CFR part 225, appendix C, provided that the Board may by order apply any or all of this part 217 to any bank holding company, based on the institution's size, level of complexity, risk profile, scope of operations, or financial condition; or

(C) A covered savings and loan holding company domiciled in the United States, other than a savings and loan holding company that meets the requirements of 12 CFR part 225, appendix C, as if the savings and loan holding company were a bank holding company and the savings association were a bank. For purposes of compliance with the capital adequacy requirements and calculations in this part, savings and loan holding companies that do not file the FR Y-9C or the FR Q-1 should follow the instructions to the FR Y-9C.

(ii) *Mid-tier holding companies of insurance depository institution holding companies.*

In the case of a bank holding company, or a covered savings and loan holding company, that

does not calculate minimum risk-based capital requirements under subpart B of this part by operation of § 217.10(f)(1), this part applies to a depository institution holding company that is a subsidiary of such bank holding company or covered savings and loan holding company, provided that:

- (A) The subsidiary depository institution holding company is an insurance mid-tier holding company; and
- (B) The subsidiary depository institution holding company's assets and liabilities are not consolidated with those of a depository institution holding company that controls the subsidiary for purposes of determining the parent depository institution holding company's capital requirements and capital ratios under subparts B through F of this part.

\* \* \* \*

(g) *Deppository institution holding companies and treatment of subsidiary state-regulated insurers, regulated foreign subsidiaries, and regulated foreign affiliates.*

(1) *In general.* In complying with the capital adequacy requirements of this part (except for the requirements and calculations of subpart J of this part), including any determination of applicability under § 217.100 or § 217.201, an insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company may elect not to consolidate the assets and liabilities of its subsidiary state-regulated insurers, regulated foreign subsidiaries, and regulated foreign affiliates. Such an institution that makes this election must either:

(i) Deduct from the sum of its common equity tier 1 capital elements the aggregate amount of its outstanding equity investment, including retained earnings, in such subsidiaries and affiliates; or

(ii) Include in the risk-weighted assets of the Board-regulated institution the aggregate amount of its outstanding equity investment, including retained earnings, in such subsidiaries and affiliates and assign to these assets a 400 percent risk weight.

(2) *Method of election.* (i) An insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company may make the election described in paragraph (g)(1) of this section by indicating that it has made this election on the applicable regulatory report, filed by the insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company for the first reporting period in which it is an insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company. The electing Board-regulated institution must indicate on the applicable regulatory report whether it elects to deduct from the sum of its common equity tier 1 capital elements in accordance with paragraph (g)(1)(i) of this section or whether it elects to include an amount in its risk-weighted assets in accordance with paragraph (g)(1)(ii) of this section.

(ii) An insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company that has not made an effective election pursuant to paragraph (g)(2)(i) of this section, or that seeks to change its election (or its choice of treatment under paragraph (g)(1) of this section) due to a change in control, business combination, or other legitimate business purpose, may do so only with the prior approval of the Board, effective as of

the first reporting period after the period in which the Board approves the election, or such other date specified in the approval.

3. In § 217.2:

- a. Revise the definition of “covered savings and loan holding company”; and
- b. Add the definitions of “insurance bank holding company,” “insurance mid-tier holding company”, “insurance savings and loan holding company”, “regulated foreign subsidiary and regulated foreign affiliate”, and “state-regulated insurer”.

The revision and additions read as follows:

**§ 217.2                    Definitions.**

\*                    \*                    \*                    \*

*Covered savings and loan holding company* means a top-tier savings and loan holding company other than an institution that—

- (1) Meets the requirements of section 10(c)(9)(C) of the Home Owners’ Loan Act (12 U.S.C. 1467a(c)(9)(C)); and
- (2) As of June 30 of the previous calendar year, derived 50 percent or more of its total consolidated assets or 50 percent of its total revenues on an enterprise-wide basis (as calculated under GAAP) from activities that are not financial in nature under section 4(k) of the Bank Holding Company Act (12 U.S.C. 1843(k)).

\*                    \*                    \*                    \*

*Insurance bank holding company* means:

- (1)(i) A bank holding company that is an insurance underwriting company; or
- (ii) A bank holding company that, as of June 30 of the previous calendar year, held 25 percent or more of its total consolidated assets in subsidiaries that are insurance underwriting companies (other than assets associated with insurance underwriting for credit risk).

(2) For purposes of this definition, the company must calculate its total consolidated assets in accordance with GAAP, or if the company does not calculate its total consolidated assets under GAAP for any regulatory purpose (including compliance with applicable securities laws), the company may estimate its total consolidated assets, subject to review and adjustment by the Board.

*Insurance mid-tier holding company* means a bank holding company, or savings and loan holding company, domiciled in the United States that:

- (1) Is a subsidiary of:
  - (i) An insurance bank holding company to which subpart J of this part applies; or
  - (ii) an insurance savings and loan holding company to which subpart J of this part applies; and
- (2) Is not an insurance underwriting company that is subject to state law capital requirements.

*Insurance savings and loan holding company* means:

- (1)(i) A top-tier savings and loan holding company that is an insurance underwriting company; or

(ii) A top-tier savings and loan holding company that, as of June 30 of the previous calendar year, held 25 percent or more of its total consolidated assets in subsidiaries that are insurance underwriting companies (other than assets associated with insurance underwriting for credit risk).

(2) For purposes of this definition, the company must calculate its total consolidated assets in accordance with GAAP, or if the company does not calculate its total consolidated assets under GAAP for any regulatory purpose (including compliance with applicable securities laws), the company may estimate its total consolidated assets, subject to review and adjustment by the Board.

\* \* \* \*

*Regulated foreign subsidiary and regulated foreign affiliate* means a person described in section 171(a)(6) of the Dodd-Frank Act (12 U.S.C. 5371(a)(6)) and any subsidiary of such a person other than a state-regulated insurer.

\* \* \* \*

*State-regulated insurer* means a person regulated by a state insurance regulator as defined in section 1002(22) of the Dodd-Frank Act (12 U.S.C. 5481(22)), and any subsidiary of such a person, other than a regulated foreign subsidiary and regulated foreign affiliate.

\* \* \* \*

## **Subpart B—Capital Ratio Requirements and Buffers**

4. In § 217.10, add paragraph (f) to read as follows:

**§ 217.10 Minimum capital requirements.**

\* \* \* \*

(f) *Insurance depository institution holding companies.* Notwithstanding paragraphs (a) through (d) of this section:

- (1) An insurance bank holding company that is a state-regulated insurer, or an insurance savings and loan holding company that is a state-regulated insurer, is not required to meet the minimum capital ratio requirements in paragraphs (a)(1)(i) through (iii) of this section if the company is subject to subpart J of this part; and
- (2) A Board-regulated institution that is an insurance bank holding company, insurance savings and loan holding company, or insurance mid-tier holding company is not required to meet the minimum capital ratio requirements in paragraphs (a)(1)(iv) and (v) of this section.

5. In § 217.11, add paragraph (e) to read as follows:

**§ 217.11 Capital conservation buffer, countercyclical capital buffer amount, and GSIB surcharge.**

\* \* \* \*

(e) *Insurance depository institution holding companies.* Notwithstanding any other provision of this section:

- (1) A Board-regulated institution that is an insurance bank holding company that is subject to subpart J of this part calculates its capital conservation buffer in accordance with § 217.604;

(2) A Board-regulated institution that is an insurance savings and loan holding company that is subject to subpart J of this part calculates its capital conservation buffer in accordance with § 217.604; and

(3) A Board-regulated institution that is an insurance mid-tier holding company is not subject to the provisions of this section.

## **Subpart G—Transitional Provisions**

6. Add § 217.306 to read as follows:

### **§ 217.306 Building Block Approach capital conservation buffer transition.**

(a) Notwithstanding any provision of this part and subject to paragraph (b) of this section, an insurance bank holding company, or insurance savings and loan holding company, that, on January 1, 2023, was not subject to this part is not subject to any restrictions on distributions or discretionary bonus payments under §§ 217.11 and 217.604.

(b) This section ceases to be effective after March 31, 2026.

7. In part 217, add a new subpart J, to read as follows:

## **Subpart J—Risk-Based Capital Requirements for Board-regulated Institutions**

### **Significantly Engaged in Insurance Activities**

Sec.

§ 217.601 Purpose, applicability, and reservations of authority.

§ 217.602 Definitions.

§ 217.603 BBA ratio and minimum requirements.

§ 217.604 Capital conservation buffer.

§ 217.605 Determination of building blocks.

§ 217.606 Scaling parameters.

§ 217.607 Capital requirements under the Building Block Approach.

§ 217.608 Available capital resources under the Building Block Approach.

**§ 217.601 Purpose, applicability, and reservations of authority.**

(a) *Purpose.* This subpart establishes a framework for assessing overall risk-based capital for Board-regulated institutions that are significantly engaged in insurance activities. The framework in this subpart J is used to measure available capital resources and capital requirements across a Board-regulated institution and its subsidiaries that are subject to diverse capital frameworks, aggregate available capital resources and capital requirements and calculate a ratio that reflects the overall capital adequacy of the Board-regulated institution.

(b) *Applicability.* This subpart applies to every Board-regulated institution that is:

(1) A top-tier depository institution holding company that is an insurance underwriting company; or

(2) A top-tier depository institution holding company, that, as of June 30 of the previous calendar year, held 25 percent or more of its total consolidated assets in insurance underwriting companies (other than assets associated with insurance underwriting for credit risk). For purposes of this paragraph (b)(2), the Board-regulated institution must calculate its total consolidated assets in accordance with GAAP, or if the Board-regulated institution does not calculate its total consolidated assets under GAAP for any regulatory purpose (including

compliance with applicable securities laws), the company may estimate its total consolidated assets, subject to review and adjustment by the Board; or

- (3) Depository institution holding company in a supervised insurance organization; or
- (4) An institution that is otherwise made subject to this subpart by the Board.

(c) *Exclusion of certain depository institution holding companies.* Notwithstanding paragraph (b) of this section, this subpart does not apply to a top-tier depository institution holding company that—

- (1) Exclusively files financial statements in accordance with SAP;
- (2) Is not subject to a state insurance capital requirement; and
- (3) Has no subsidiary depository institution holding company that—
  - (i) Is subject to a capital requirement; or
  - (ii) Does not exclusively file financial statements in accordance with SAP.

(d) *Reservation of authority.*

- (1) *Regulatory capital resources.*
  - (i) If the Board determines that a particular company capital element has characteristics or terms that diminish its ability to absorb losses, or otherwise present safety and soundness concerns, the Board may require the supervised insurance organization to exclude all or a portion of such element from building block available capital for a depository institution holding company in the supervised insurance organization.

(ii) Notwithstanding any provision of § 217.608, the Board may find that a capital resource may be included in the building block available capital of a depository institution holding company on a permanent or temporary basis consistent with the loss absorption capacity of the capital resource and in accordance with § 217.608(g).

(2) *Required capital amounts.* If the Board determines that the building block capital requirement for any depository institution holding company is not commensurate with the risks of the depository institution holding company, the Board may adjust the building block capital requirement and building block available capital for the supervised insurance organization.

(3) *Structural requirements.* In order to achieve the appropriate application of this subpart, the Board may require a supervised insurance organization to take any of the following actions with respect to the application of this subpart, if the Board determines that such action would better reflect the risk profile of an inventory company or the supervised insurance organization:

(i) Identify components under this subpart J differently than as done by the supervised insurance organization. This could include a different identification of a top-tier depository institution holding company, an inventory company, a material financial entity, or a building block parent, then that made by the supervised insurance organization; or

(ii) Set a building block parent's allocation share of a downstream building block parent equal to 100 percent.

(4) *Other reservation of authority.* With respect to any treatment required under this subpart, the Board may require a different treatment, provided that such alternative treatment is

commensurate with the supervised insurance organization's risk and consistent with safety and soundness.

(e) *Notice and response procedures.* In making any determinations under paragraph (d) of this section, the Board will apply notice and response procedures in the same manner as the notice and response procedures in § 263.202 of this chapter.

## **§ 217.602      Definitions.**

(a) Terms that are set forth in § 217.2 and used in this subpart J have the definitions assigned thereto in 12 CFR 217.2.

(b) For the purposes of this subpart J, the following terms are defined as follows:

*Allocation share* means the portion of a downstream building block's available capital or building block capital requirement that a building block parent must aggregate in calculating its own building block available capital or building block capital requirement, as applicable, and calculated in accordance with § 217.605(d).

*Assignment* means the process of associating an inventory company with one or more building block parents for purposes of inclusion in the building block parents' building blocks.

*BBA ratio* is defined in § 217.603.

*Building block* means a building block parent and all downstream companies and subsidiaries assigned to the building block parent.

*Building block available capital* has the meaning set out in § 217.608.

*Building block capital requirement* has the meaning set out in § 217.607.

*Building block parent* means the lead company of a building block whose indicated capital framework must be applied to all members of a building block for purposes of determining building block available capital and the building block capital requirement.

*Capital-regulated company* means a company that is—

- (1) A depository institution, foreign bank, or company engaged in the business of insurance in a supervised insurance organization; and
- (2) Directly subject to a regulatory capital framework.

*Common capital framework* means NAIC RBC.

*Company available capital* means, for a company, the amount of its capital elements, net of any adjustments and deductions, as determined in accordance with the company's indicated capital framework.

*Company capital element* means any part, item, component, balance sheet account, instrument, or other element qualifying as regulatory capital under a company's indicated capital framework prior to any adjustments and deductions under that framework.

*Company capital requirement* means:

- (1) For a company whose indicated capital framework is NAIC RBC, the Authorized Control Level risk-based capital requirement as set forth in NAIC RBC;
- (2) For a company whose indicated capital framework is a U.S. federal banking capital rule, the total risk-weighted assets; and

(3) For any other company, a risk-sensitive measure of required capital used to determine the jurisdictional intervention point applicable to that company.

*Downstream building block parent* means a building block parent that is a downstream company of another building block parent.

*Downstream company* means a company whose company capital element is directly or indirectly owned, in whole or in part, by another company in the supervised insurance organization.

*Downstreamed capital* means direct ownership of a downstream company's company capital element that is accretive to a downstream building block parent's building block available capital.

*Financial entity* means:

- (1) A bank holding company; a savings and loan holding; a U.S. intermediate holding company established or designated for purposes of compliance with part 252 of this chapter;
- (2) A depository institution as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)); an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States; a federal credit union or state credit union; a national association, state member bank, or state nonmember bank that is not a depository institution; an institution that functions solely in a trust or fiduciary capacity; an industrial loan company, an industrial bank, or other similar institution;
- (3) An entity that is state-licensed or registered as:

(i) A credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

(ii) A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

(4) Any person registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act (7 U.S.C. 1 *et seq.*), or an entity that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*);

(5) A securities holding company as defined in section 618 of the Dodd-Frank Act (12 U.S.C. 1850a); a broker or dealer as defined in sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)–(5)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-53(a));

(6) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) but for section 3(c)(5)(C) of that Act; or an

entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a-7 (17 CFR 270.3a-7) of the U.S. Securities and Exchange Commission;

(7) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in sections 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(10), 1a(11), and 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in sections 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in section 1a(28) of the Commodity Exchange Act (7 U.S.C. 1a(28));

(8) An entity that is organized as an insurance company, primarily engaged in underwriting insurance or reinsuring risks underwritten by insurance companies;

(9) Any designated financial market utility, as defined in section 803 of the Dodd-Frank Act (12 U.S.C. 5462); and

(10) An entity that would be a financial entity described in paragraphs (1) through (9) of this definition, if it were organized under the laws of the United States or any State thereof.

*Indicated capital framework* is defined in § 217.605, provided that for purposes of § 217.605(b)(2), the NAIC RBC frameworks for life insurance and fraternal insurers, P&C insurance, and health insurance companies are different indicated capital frameworks.

*Inventory company* means a company identified pursuant to § 217.605(b)(1).

*Material* means, for a company in the supervised insurance organization:

(1) Where the top-tier depository institution holding company's total exposure to the company exceeds 5 percent of the maximum of—

- (i) Top-tier depository institution holding company's company available capital; and
- (ii) The largest company available capital of all capital regulated companies reported in the supervised insurance organization's inventory; or

(2) The company is otherwise significant when assessing the building block available capital or building block capital requirement of the top-tier depository institution holding company based on factors including risk exposure, activities, organizational structure, complexity, affiliate guarantees or recourse rights, and size.

(3) For purposes of this definition, total exposure includes:

- (i) The absolute value of the top-tier depository institution holding company's direct or indirect interest in the company capital elements of the company;
- (ii) The maximum possible loss from a guarantee (explicit or implicit) the top-tier depository institution holding company or any other company in the supervised insurance organization provides for the benefit of the company; and
- (iii) Maximum potential counterparty credit risk to the top-tier depository institution holding company or any other company in the supervised insurance organization arising from any derivative or similar instrument, reinsurance or similar arrangement, or other contractual agreement.

*Material financial entity* means a financial entity that, together with its subsidiaries, but excluding any subsidiary capital-regulated company (or subsidiary thereof), is material, provided that an inventory company is not eligible to be a material financial entity if:

- (1) The supervised insurance organization has elected pursuant to § 217.605(c) not to treat the company as a material financial entity; or
- (2) The inventory company is a financial subsidiary, as defined in section 121 of the Gramm-Leach-Bliley Act.

*Member* means, with respect to a building block, the building block parent or any of its downstream companies or subsidiaries that have been assigned to a building block.

*NAIC* means the National Association of Insurance Commissioners.

*NAIC RBC* means the most recent version of the Risk-Based Capital (RBC) For Insurers Model Act, together with the RBC instructions, as adopted in a substantially similar manner by an NAIC member and published in the NAIC's Model Regulation Service.

*Permitted accounting practice* means an accounting practice, specifically requested by a state-regulated insurer, that departs from SAP and state prescribed accounting practices and has been approved by the state-regulated insurer's domiciliary state regulatory authority.

*Prescribed accounting practice* means an accounting practice that is incorporated directly or by reference to state laws, regulations, and general administrative rules applicable to all insurance companies domiciled in a particular state.

*Principles based reserving (PBR)* means the valuation standard adopted for certain life insurance reserves by the NAIC effective as of January 1, 2020.

*Recalculated building block capital requirement* means, for a downstream building block parent and an upstream building block parent, the downstream building block parent's building block capital requirement recalculated assuming that the downstream building block parent had no upstream investment in the upstream building block parent.

*Regulatory capital framework* means, with respect to a company, the applicable legal requirements, excluding this subpart J, specifying the minimum amount of total regulatory capital the company must hold to avoid restrictions on distributions and discretionary bonus payments, regulatory intervention on the basis of capital adequacy levels for the company, or equivalent standards; provided that the NAIC RBC frameworks for life and fraternal insurance, P&C insurance, and health insurance companies are different regulatory capital frameworks.

*SAP* means Statutory Accounting Principles as promulgated by the NAIC and adopted by a jurisdiction for purposes of financial reporting by insurance companies.

*Scaling* means the translation of building block available capital and building block capital requirement from one indicated capital framework to another by application of § 217.606.

*Scalar compatible* means a capital framework:

- (1) For which the Board has determined scalars; or
- (2) That is an insurance capital regulatory framework, and exhibits each of the following three attributes:
  - (i) The framework is clearly defined and broadly applicable;
  - (ii) The framework has an identifiable regulatory intervention point that can be used to calibrate a scalar; and

(iii) The framework provides a risk-sensitive measure of required capital reflecting material risks to a company's financial strength.

*Submission date* means the date as of which form FR Q-1 is filed with the Board.

*Supervised insurance organization* means:

(1) In the case of a depository institution holding company, the set of companies consisting of:

(i) A top-tier depository institution holding company that is an insurance underwriting company, together with its inventory companies; or

(ii) A top-tier depository institution holding company, together with its inventory companies, that, as of June 30 of the previous calendar year, held 25 percent or more of its total consolidated assets in insurance underwriting companies (other than assets associated with insurance underwriting for credit risk). For purposes of this paragraph (1)(ii) of this definition, the supervised firm must calculate its total consolidated assets in accordance with GAAP, or if the firm does not calculate its total consolidated assets under GAAP for any regulatory purpose (including compliance with applicable securities laws), the company may estimate its total consolidated assets, subject to review and adjustment by the Board; or

(2) An institution that is otherwise subject to this subpart J, as determined by the Board, together with its inventory companies.

*Tier 2 capital instruments* has the meaning set out in § 217.608(a).

*Top-tier depository institution holding company* means a depository institution holding company that is not controlled by another depository institution holding company.

*Upstream building block parent* means an upstream company that is a building block parent.

*Upstream company* means a company within a supervised insurance organization that directly or indirectly controls a downstream company, or directly or indirectly owns part or all of a downstream company's company capital elements.

*Upstream investment* means any direct or indirect investment by a downstream building block parent in an upstream building block parent.

*U.S. federal banking capital rules* mean this part, other than this subpart J, and the regulatory capital rules promulgated by the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

### **§ 217.603 BBA ratio and minimum requirements.**

(a) *In general.* A supervised insurance organization must determine its BBA ratio, subject to the minimum requirement set out in this section and buffer set out in § 217.604, for each depository institution holding company within its enterprise by:

- (1) Establishing an inventory that includes the supervised insurance organization and every company that meets the requirements of § 217.605(b)(1);
- (2) Identifying all building block parents as required under § 217.605(b)(3);
- (3) Determining the available capital and capital requirement for each building block parent in accordance with its indicated capital framework;
- (4) Determining the building block available capital and building block capital requirement for each building block, reflecting adjustments and scaling as set out in this subpart;

(5) Rolling up building block available capital and building block capital requirement amounts across all building blocks in the supervised insurance organization's enterprise to determine the same for any depository institution holding companies in the enterprise; and

(6) Determining the ratio of building block available capital to building block capital requirement for each depository institution holding company in the supervised insurance organization.

(b) *Determination of BBA ratio.* For a depository institution holding company in a supervised insurance organization, the BBA ratio is the ratio of the company's building block available capital to the company's building block capital requirement, each scaled to the common capital framework in accordance with § 217.606.

(c) *Minimum capital requirement.* A depository institution holding company in a supervised insurance organization must maintain a BBA ratio of at least 250 percent.

(d) *Capital adequacy.* (1) Notwithstanding the minimum requirement in this subpart, a depository institution holding company in a supervised insurance organization must maintain capital commensurate with the level and nature of all risks to which it is exposed. The supervisory evaluation of the depository institution holding company's capital adequacy is based on an individual assessment of numerous factors, including the character and condition of the company's assets and its existing and prospective liabilities and other corporate responsibilities.

(2) A depository institution holding company in a supervised insurance organization must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital.

**§ 217.604      Capital conservation buffer.**

(a) *Capital conservation buffer.*

(1) *Composition of the capital conservation buffer.* The capital conservation buffer is composed solely of building block available capital excluding tier 2 capital instruments and additional tier 1 capital instruments.

(2) *Definitions.* For purposes of this section, the following definitions apply:

(i) *Distribution* means:

(A) A reduction of tier 1 capital through the repurchase of a tier 1 capital instrument or by other means, except when a Board-regulated institution, within the same quarter when the repurchase is announced, fully replaces a tier 1 capital instrument it has repurchased by issuing another capital instrument that meets the eligibility criteria for:

(1) A common equity tier 1 capital instrument if the instrument being repurchased was part of the Board-regulated institution's common equity tier 1 capital, or

(2) A common equity tier 1 or additional tier 1 capital instrument if the instrument being repurchased was part of the Board-regulated institution's tier 1 capital;

(B) A reduction of tier 2 capital through the repurchase, or redemption prior to maturity, of a tier 2 capital instrument or by other means, except when a Board-regulated institution, within the same quarter when the repurchase or redemption is announced, fully replaces a tier 2 capital instrument it has repurchased by issuing another capital instrument that meets the eligibility criteria for a tier 1 or tier 2 capital instrument;

(C) A dividend declaration or payment on any tier 1 capital instrument;

(D) A dividend declaration or interest payment on any tier 2 capital instrument if the Board-regulated institution has full discretion to permanently or temporarily suspend such payments without triggering an event of default;

(E) A discretionary dividend payment on participating insurance policies; or

(F) Any similar transaction that the Board determines to be in substance a distribution of capital.

(ii) *Eligible retained income.* The eligible retained income of a depository institution holding company in a supervised insurance organization is the annual change in the company's building block available capital, calculated as of the last day of the current and immediately preceding calendar years based on the supervised insurance organization's most recent form FR Q-1, net of any distributions and accretion to building block available capital from capital instruments issued in the current or immediately preceding calendar year, excluding issuances corresponding with retirement of capital instruments under paragraph (a)(2)(i)(A) of this section.

(iii) *Maximum payout amount.* A Board-regulated institution's maximum payout amount for the current calendar year is equal to the Board-regulated institution's eligible retained income, multiplied by its maximum payout ratio.

(iv) *Maximum payout ratio.* The maximum payout ratio is the percentage of eligible retained income that a Board-regulated institution can pay out in the form of distributions and discretionary bonus payments during the current calendar year. The maximum payout ratio is determined by the Board-regulated institution's capital conservation buffer, calculated as of the last day of the previous calendar year, as set forth in Table 1 to this section.

(3) *Calculation of capital conservation buffer.* The capital conservation buffer for a depository institution holding company in a supervised insurance organization is the greater of its BBA ratio, calculated as of the last day of the previous calendar year based on the supervised insurance organization's most recent form FR Q-1, minus the minimum capital requirement under § 217.603(c), and zero.

(4) *Limits on distributions and discretionary bonus payments.*

(i) A top-tier depository institution holding company in a supervised insurance organization shall not make distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar year that, in the aggregate, exceed its maximum payout amount.

(ii) A top-tier depository institution holding company in a supervised insurance organization and that has a capital conservation buffer that is greater than 150 percent is not subject to a maximum payout amount under this section.

(iii) Except as provided in paragraph (a)(4)(iv) of this section, a top-tier depository institution holding company in a supervised insurance organization may not make distributions or discretionary bonus payments during the current calendar year if the Board-regulated institution's:

(A) Eligible retained income is negative; and

(B) Capital conservation buffer was less than 150 percent as of the end of the previous calendar year.

(iv) Notwithstanding the limitations in paragraphs (a)(4)(i) through (iii) of this section, the Board may permit a top-tier depository institution holding company in a supervised insurance

organization to make a distribution or discretionary bonus payment upon a request of the depository institution holding company, if the Board determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the depository institution holding company. In making such a determination, the Board will consider the nature and extent of the request and the particular circumstances giving rise to the request.

(b) [Reserved].

Table 1 to § 217.604—Calculation of Maximum Payout Amount	
Capital conservation buffer	Maximum payout ratio (as a percentage of eligible retained income)
Greater than 150 percent.	No payout ratio limitation applies
Less than or equal to 150 percent, <i>and</i> greater than 113 percent.	60 percent.
Less than or equal to 113 percent, <i>and</i> greater than 75 percent.	40 percent.
Less than or equal to 75 percent, <i>and</i> greater than 38 percent.	20 percent.
Less than or equal to 38 percent.	0 percent.

## § 217.605 Determination of building blocks.

(a) *In general.* A supervised insurance organization must identify each building block parent and its allocation share of any downstream building block parent, as applicable.

(b) *Operation.* To identify building block parents and determine allocation shares, a supervised insurance organization must take the following steps in the following order:

(1) *Inventory of companies.* A supervised insurance organization must identify as inventory companies:

- (i) All companies that are—
  - (A) Required to be reported on the FR Y-6;
  - (B) Required to be reported on the FR Y-10; or
  - (C) Classified as affiliates in accordance with NAIC Statement of Statutory Accounting Principles (SSAP) No. 25 and Schedule Y;
- (ii) Any company, special purpose entity, variable interest entity, or similar entity that:
  - (A) Enters into one or more reinsurance or derivative transactions with inventory companies identified pursuant to paragraph (b)(1)(i) of this section;
  - (B) Is material;
  - (C) Is engaged in activities such that one or more inventory companies identified pursuant to paragraph (b)(1)(i) of this section are expected to absorb more than 50 percent of its expected losses; and
  - (D) Is not otherwise identified as an inventory company; and
- (iii) Any other company that the Board determines must be identified as an inventory company.

(2) *Determination of indicated capital framework.*

- (i) A supervised insurance organization must:
  - (A) Determine the indicated capital framework for each inventory company; and

(B) Identify inventory companies that are subject to a regulatory capital framework.

(ii) The indicated capital framework for an inventory company is:

(A) If the inventory company is not engaged in insurance or reinsurance underwriting, the U.S. federal banking capital rules, in particular:

(1) If the inventory company is not a depository institution, subparts A through F of this part; and

(2) If the inventory company is a depository institution, the regulatory capital framework applied to the depository institution by the appropriate primary federal regulator—that is, subparts A through F of this part (Board), part 3 of this title (Office of the Comptroller of the Currency), or part 324 of this title (Federal Deposit Insurance Corporation), as applicable;

(B) If the inventory company is engaged in insurance or reinsurance underwriting and subject to a regulatory capital framework that is scalar compatible, the regulatory capital framework; and

(C) If the inventory company is engaged in insurance or reinsurance underwriting and not subject to a regulatory capital framework that is scalar compatible, then NAIC RBC for life and fraternal insurers, health insurers, or property & casualty insurers based on the company's primary source of premium revenue.

(3) *Identification of building block parents.* A supervised insurance organization must identify all building block parents according to the following procedure:

(i) (A) Identify all top-tier depository institution holding companies in the supervised insurance organization.

(B) Any top-tier depository institution holding company is a building block parent.

(ii) (A) Identify any inventory company that is a depository institution holding company.

(B) An inventory company identified in paragraph (b)(3)(ii)(A) of this section is a building block parent.

(iii) Identify all inventory companies that are capital-regulated companies (that is, inventory companies that are subject to a regulatory capital framework) or material financial entities.

(iv) (A) Of the inventory companies identified in paragraph (b)(3)(iii) of this section, identify any inventory company that:

(1) Is assigned an indicated capital framework that is different from the indicated capital framework of any next upstream inventory company identified in paragraphs (b)(3)(i) through (iii) of this section or does not have a next upstream inventory company;<sup>1</sup> and

(2) Is assigned an indicated capital framework for which the Board has determined a scalar or, if the company in aggregate with all other companies subject to the same indicated capital framework are material, a provisional scalar;

(B) Of the inventory companies identified in paragraph (b)(3)(iii) of this section, identify any inventory company that:

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<sup>1</sup> In a simple structure, an inventory company would compare its indicated capital framework to the indicated capital framework of its parent company. However, if the parent company does not meet the criteria to be identified as a building block parent, the inventory company must compare its capital framework to the next upstream company that is eligible to be identified as a building block parent. For purposes of this subparagraph (iv), a company is “next upstream” to a downstream company if it controls or owns, in whole or in part, a company capital element of the downstream company either directly, or indirectly other than through a company identified in paragraphs (b)(3)(ii)-(iii) of this section.

(1) Is assigned an indicated capital framework that is the same as the indicated capital framework of each next upstream inventory company identified in paragraphs (b)(3)(i) through (iii) of this section;

(2) Is assigned an indicated capital framework for which the Board has determined a scalar or, if the company in aggregate with all other companies subject to the same indicated capital framework is material, a provisional scalar; and

(3) Is owned, in whole or part, by an inventory company that is subject to the same regulatory capital framework, and the owner:

(i) Applies a charge on the inventory company's equity value in calculating its company capital requirement; or

(ii) Deducts all or a portion of its investment in the inventory company in calculating its company available capital.

(C) An inventory company identified in paragraph (b)(3)(iv)(A) through (B) of this section is a building block parent.

(v) Include any inventory company identified in paragraph (b)(1)(ii) of this section as a building block parent.

(vi) (A) Identify any inventory company—

(1) For which more than one building block parent, as identified pursuant to paragraphs (b)(3)(i) through (v) of this section, owns a company capital element either directly or indirectly other than through another such building block parent; and

(2) (i) Is consolidated under any such building block parent's indicated capital framework; or

(ii) Owns downstreamed capital.

(B) An inventory company identified in paragraph (b)(3)(vi)(A) of this section is a building block parent.

(4) *Building blocks.* (i) Except as provided in paragraph (b)(4)(ii) of this section, a supervised insurance organization must assign an inventory company to the building block of any building block parent that owns a company capital element of the inventory company, or of which the inventory company is a subsidiary,<sup>2</sup> directly or indirectly through any company other than a building block parent, unless the inventory company is a building block parent.

(ii) A supervised insurance organization is not required to assign to a building block any inventory company that is not a downstream company or subsidiary of a top-tier depository institution holding company.

(5) *Financial statements.* The supervised insurance organization must:

(i) For any inventory company whose indicated capital framework is NAIC RBC, prepare financial statements in accordance with SAP; and

(ii) For any building block parent whose indicated capital framework is subparts A through F of this part:

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<sup>2</sup> For purposes of this section, subsidiary includes a company that is required to be reported on the FR Y-6, FR Y-10, or NAIC's Schedule Y, as applicable.

- (A) Apply the same elections and treatment of exposures as are applied to the subsidiary depository institution;
- (B) Apply subparts A through F of this part, to the members of the building block of which the building block parent is a member, on a consolidated basis, to the same extent as if the building block parent were a Board-regulated institution; and
- (C) Where the building block parent is not the top-tier depository institution holding company, not deduct investments in capital of unconsolidated financial institutions, nor exclude these investments from the calculation of risk-weighted assets.

(6) *Allocation share.* A supervised insurance organization must, for each building block parent, identify any downstream building block parent owned directly or indirectly through any company other than a building block parent, and determine the building block parent's allocation share of these downstream building block parents pursuant to paragraph (d) of this section.

(c) *Material financial entity election.* (1) A supervised insurance organization may elect not to treat an inventory company meeting the criteria in paragraph (c)(2) of this section as a material financial entity. An election under this paragraph (c)(1) must be included with the first financial statements submitted to the Board after the company is included in the supervised insurance organization's inventory.

(2) The election in paragraph (c)(1) of this section is available to an inventory company if:

- (i) The company engages in transactions consisting solely of either—
  - (A) Transactions for the purpose of transferring risk from one or more affiliates within the supervised insurance organization to one or more third parties; or

(B) Transactions to invest assets contributed to the company by one or more affiliates within the supervised insurance organization, where the company is established for purposes of limiting tax obligation or legal liability; and

(ii) The supervised insurance organization is able to calculate the adjustment required in § 217.607(b)(4).

(d) *Allocation share.* (1) Except as provided in paragraph (d)(2) of this section, a building block parent's allocation share of a downstream building block parent is calculated as the percentage of equity ownership of a downstream building block parent, including associated paid-in capital, held by an upstream building block parent directly or indirectly through a member of the upstream building block parent's building block.

(2) The top-tier depository institution holding company's allocation share of a building block parent that has no outstanding common equity or that is identified under paragraph (b)(3)(v) of this section is 100 percent. Any other building block parent's allocation share of such building block parent is zero.

## **§ 217.606 Scaling parameters.**

(a) *Scaling specified by the Board.*

(1) *Scaling between the U.S. federal banking capital rules and NAIC RBC.*

(i) *Scaling capital requirement.* When calculating the building block capital requirement for a building block parent in accordance with § 217.607, where the indicated capital framework is NAIC RBC or the U.S. federal banking capital rules, and where the indicated capital framework of the appropriate downstream building block parent is NAIC RBC or the U.S.

federal banking capital rules, the capital requirement scaling modifier is provided by Table 1 to this paragraph (a)(1)(i).

Table 1 to paragraph (a)(1)(i)—Capital Requirement Scaling Modifiers for NAIC RBC and the U.S. Federal Banking Capital Rules

		Upstream building block parent's indicated capital framework:	
		NAIC RBC	U.S. federal banking capital rules
Downstream building block parent's indicated capital framework:	U.S. federal banking capital rules	0.0106	1
	NAIC RBC	1	94.3

(ii) *Scaling available capital.* When calculating the building block available capital for a building block parent in accordance with § 217.608, where the indicated capital framework is NAIC RBC or the U.S. federal banking capital rules, and where the indicated capital framework of the appropriate downstream building block parent is NAIC RBC or the U.S. federal banking capital rules, the available capital scaling modifier is provided by Table 2 to this paragraph (a)(1)(ii).

Table 2 to paragraph (a)(1)(ii)—Available Capital Scaling Modifiers for NAIC RBC and the U.S. Federal Banking Capital Rules

		Upstream building block parent's indicated capital framework:	
		NAIC RBC	U.S. federal banking capital rules
Downstream building block parent's indicated	U.S. federal banking capital rules	Recalculated building block capital requirement *0.063	0

capital framework:	NAIC RBC	0	Recalculated building block capital requirement * 5.9
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(2) *Scaling to determine BBA ratio.* For purposes of determining the BBA ratio under § 217.603(b)—

(i) A depository institution holding company for which the indicated capital framework is the U.S. federal banking capital rules scales its building block available capital and building block capital requirement the common capital framework by using the methods described in paragraphs (a)(1) of this section. For purposes of scaling under this paragraph (a)(2)(i), the downstream building block parent's indicated capital framework is the U.S. federal banking capital rules and the upstream building block parent's indicated capital framework is NAIC RBC; and

(ii) A depository institution holding company for which the indicated capital framework is NAIC RBC does not scale its building block available capital or building block capital requirement.

(b) *Scaling not specified by the Board but framework is scalar compatible.*<sup>1</sup> Where a scaling modifier to be used in § 217.607 or § 217.608 is not specified in paragraph (a) of this section, and the building block parent's indicated capital framework (i.e., jurisdictional capital framework) is scalar compatible, the scaling modifier is determined as follows:

(1) *Definitions.* For purposes of this section, the following definitions apply:

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<sup>1</sup> To be used only for building block parents.

(i) *Jurisdictional intervention point.* The jurisdictional intervention point is the capital level, under the laws of the jurisdiction for its domestic insurers, at which the supervisory authority in the jurisdiction may intervene as to a company subject its capital framework by imposing restrictions on distributions and discretionary bonus payments by the company or, if no such intervention may occur in a jurisdiction, then the capital level at which the supervisory authority would first have the authority to take action against a company based on its capital level.

(ii) *Jurisdiction adjustment.* The jurisdictional adjustment is the risk adjustment set forth in Table 3 to this paragraph (b)(1)(ii), based on the country risk classification set by the Organization for Economic Cooperation and Development (OECD) for the jurisdiction. This adjustment is applied to the jurisdictional intervention point.

Table 3 to paragraph (b)(1)(ii)—Jurisdictional Adjustments by OECD Country Risk

Classification

<b>OECD CRC</b>	<b>Jurisdictional Adjustment</b>
0–1, including jurisdictions with no OECD country risk classification	0 percent
2	20 percent
3	50 percent
4–6	100 percent
7	150 percent

(2) *Scaling capital requirement.* When calculating the building block capital requirement for a building block parent in accordance with § 217.607, where the indicated capital framework of the appropriate downstream building block parent is a scalar-compatible framework for which

the Board has not specified a capital requirement scaling modifier, the capital requirement scaling modifier is calculated according to the following formula:

$$\frac{(1 + Adjustment_{Scaling\ from})*\ Requirement_{Scaling\ from}}{Requirement_{Scaling\ to}}$$

Where:

$Adjustment_{Scaling\ from}$  is equal to the jurisdictional adjustment of the downstream building block parent;

$Requirement_{Scaling\ from}$  is equal to the jurisdictional intervention point of the downstream building block parent; and

$Requirement_{Scaling\ to}$  is equal to the jurisdictional intervention point of the upstream building block parent.

(3) *Scaling available capital.* When calculating the building block available capital for a building block parent in accordance with § 217.608, where the indicated capital framework of the appropriate downstream building block parent is a scalar-compatible framework for which the Board has not specified an available capital scaling modifier, the available capital scaling modifier is equal to zero.

## **§ 217.607 Capital requirements under the Building Block Approach.**

(a) *Determination of building block capital requirement.* For each building block parent, *building block capital requirement* means the sum of the items in paragraphs (a)(1) through (2) of this section:

- (1) The company capital requirement of the building block parent; that is
  - (i) Recalculated under the assumption that members of the building block parent's building block had no investment in any downstream building block parent; and is
    - (ii) Adjusted pursuant to paragraph (b) of this section;
- (2) For each downstream building block parent, the adjusted downstream building block capital requirement ( $BBCR_{ADJ}$ ), which is calculated according to the following formula:

$$BBCR_{ADJ} = BBCR_{DS} \cdot CRSM \cdot AS$$

Where:

- (i)  $BBCR_{DS}$  is equal to the building block capital requirement of the downstream building block parent recalculated under the assumption that the downstream building block parent had no upstream investment in the building block parent;
- (ii)  $CRSM$  is equal to the appropriate capital requirement scaling modifier under § 217.606; and
- (iii)  $AS$  is equal to the building block parent's allocation share of the downstream building block parent.

(b) *Adjustments in determining the building block capital requirement.* A supervised insurance organization must adjust the company capital requirement for any building block parent as follows:

- (1) *Internal credit risk charges.* A supervised insurance organization must deduct from the building block parent's company capital requirement any difference between:

- (i) The building block parent's company capital requirement; and
- (ii) The building block parent's company capital requirement recalculated excluding capital requirements related to potential for the possibility of default of any company in the supervised insurance organization.

(2) *Permitted accounting practices and prescribed accounting practices.* A supervised insurance organization must adjust<sup>1</sup> the building block parent's company capital requirement by any difference between:

- (i) The building block parent's company capital requirement, after making any adjustment in accordance with paragraph (b)(1) of this section; and
- (ii) The building block parent's company capital requirement, after making any adjustment in accordance with paragraph (b)(1) of this section, recalculated under the assumption that neither the building block parent, nor any company that is a member of that building block parent's building block, had prepared its financial statements with the application of any permitted accounting practice, prescribed accounting practice, or other practice, including legal, regulatory, or accounting procedures or standards, that departs from a solvency framework as promulgated for application in a jurisdiction.

(3) *Risks of certain intermediary entities.* Where a supervised insurance organization has made an election with respect to a company not to treat that company as a material financial entity pursuant to § 217.605(c), the supervised insurance organization must add to the company

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<sup>1</sup> The adjustment can be either positive or negative depending on the permitted or prescribed practices. In most cases, the reversal of the permitted or prescribed practice would result in an increase in the building block parent's company required capital. In rare cases, a permitted or prescribed practice could increase the insurers required capital. In this instance, this adjustment would reduce the building block parent's company required capital.

capital requirement of any building block parent, whose building block contains a member, with which the company engages in one or more transactions, and for which the company engages in one or more transactions described in § 217.605(c)(2) with a third party, any difference between:

- (i) The building block parent's company capital requirement; and
- (ii) The building block parent's company capital requirement recalculated taking into account the risks of the company, excluding internal credit risks described in paragraph (b)(1) of this section, allocated to the building block parent, reflecting the transaction(s) that the company engages in with any member of the building block parent's building block.<sup>2</sup>

*(4) Investments in own capital instruments.*

- (i) *In general.* A supervised insurance organization must deduct from the building block parent's company capital requirement any difference between:
  - (A) The building block parent's company capital requirement; and
  - (B) The building block parent's company capital requirement recalculated after assuming that neither the building block parent, nor any company that is a member of the building block parent's building block, held any investment in the building block parent's own capital instrument(s), including any net long position determined in accordance with paragraph (b)(5)(ii) of this section.

- (ii) *Net long position.* For purposes of calculating an investment in a building block parent's own capital instrument under this section, the net long position is determined in

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<sup>2</sup> The total allocation of the risks of the intermediary entity to building block parents must capture all material risks and avoid double counting.

accordance with § 217.22(h), provided that a separate account asset or associated guarantee is not regarded as an indirect exposure unless the net long position of the fund underlying the separate account asset (determined in accordance with § 217.22(h) without regard to this paragraph (b)(4)(ii)) equals or exceeds 5 percent of the value of the fund.

(5) *Risks relating to title insurance.* A supervised insurance organization must add to the building block parent's company capital requirement the amount of the building block parent's reserves for claims pertaining to title insurance, multiplied by 300 percent.

## **§ 217.608 Available capital resources under the Building Block Approach.**

### **(a) *Qualifying capital instruments.***

(1) A qualifying capital instrument with respect to a building block parent is a capital instrument that meets the following criteria:

(i) The instrument is issued and paid-in;

(ii) The instrument is subordinated to depositors and general creditors of the building block parent;

(iii) The instrument is not secured, not covered by a guarantee of the building block parent or of an affiliate of the building block parent, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument in relation to more senior claims;

(iv) The instrument has a minimum original maturity of at least five years. At the beginning of each of the last five years of the life of the instrument, the amount that is eligible to

be included in building block available capital is reduced by 20 percent of the original amount of the instrument (net of redemptions), and is excluded from building block available capital when the remaining maturity is less than one year. In addition, the instrument must not have any terms or features that require, or create significant incentives for, the building block parent to redeem the instrument prior to maturity;<sup>1</sup> and

(v) The instrument, by its terms, may be called by the building block parent only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called sooner upon the occurrence of an event that would preclude the instrument from being included in the building block parent's company available capital or building block available capital, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*). In addition:

(A) The top-tier depository institution holding company must receive the prior approval of the Board to exercise a call option on the instrument.

(B) The building block parent does not create at issuance, through action or communication, an expectation the call option will be exercised.

(C) Prior to exercising the call option, or immediately thereafter, the top-tier depository institution holding company must either: replace any amount called with an equivalent amount of an instrument that meets the criteria for qualifying capital instruments under this section;<sup>2</sup> or

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<sup>1</sup> An instrument that by its terms automatically converts into a qualifying capital instrument prior to five years after issuance complies with the five-year maturity requirement of this criterion.

<sup>2</sup> A building block parent may replace qualifying capital instruments concurrent with the redemption of existing qualifying capital instruments.

demonstrate to the satisfaction of the Board that following redemption, the top-tier depository institution holding company would continue to hold an amount of capital that is commensurate with its risk.

(vi) Redemption of the instrument prior to maturity or repurchase requires the prior approval of the Board.

(vii) The instrument meets the criteria in § 217.20(d)(1)(vi) through (ix) and § 217.20(d)(1)(xi), except that each instance of “Board-regulated institution” is replaced with “building block parent” and, in § 217.20(d)(1)(ix), “tier 2 capital instruments” is replaced with “qualifying capital instruments”.

(2) *Additional tier 1 capital instruments.* Additional tier 1 capital instruments of a top-tier depository institution holding company are instruments issued by any inventory company that are qualifying capital instruments under paragraph (a)(1) of this section<sup>3</sup> and meet all of the following criteria:

(i) The instrument is subordinated to depositors, general creditors, and subordinated debt holders of the building block parent in a receivership, insolvency, liquidation, or similar proceeding;

(ii) The instrument is not secured, not covered by a guarantee of the building block parent or of an affiliate of the building block parent, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument;

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<sup>3</sup> For purposes of this paragraph (a)(2), the supervised insurance organization evaluates the criteria in paragraph (a)(1) of this section with regard to the building block in which the issuing inventory company is a member.

(iii) The instrument has no maturity date and does not contain a dividend step-up or any other term or feature that creates an incentive to redeem; and

(iv) If callable by its terms, the instrument may be called only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called earlier than five years upon the occurrence of a regulatory event that precludes the instrument from being included in the building block parent's company available capital or building block available capital, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*). In addition:

(A) The top-tier depository institution holding company must receive the prior approval of the Board to exercise a call option on the instrument.

(B) The building block parent does not create at issuance, through action or communication, an expectation that the call option will be exercised.

(C) Prior to exercising the call option, or immediately thereafter, the top-tier depository institution holding company must either: replace any amount called with an equivalent amount of an instrument that meets the criteria for additional tier 1 capital instruments or common equity tier 1 instruments under this section;<sup>4</sup> or demonstrate to the satisfaction of the Board that following redemption, the top-tier depository institution holding company would continue to hold an amount of capital that is commensurate with its risk.

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<sup>4</sup> A building block parent may replace qualifying capital instruments concurrent with the redemption of existing qualifying capital instruments.

- (v) Redemption or repurchase of the instrument requires prior approval of the Board.
- (vi) The paid-in amount would be classified as equity under GAAP.
- (vii) The instrument meets the criteria in §§ 217.20(c)(1)(vii) through (ix) and 217.20(c)(1)(xi) through (xiv), except that each instance of “Board-regulated institution” is replaced with “building block parent”.

(3) *Common equity tier 1 capital instruments.* Common equity tier 1 capital instruments of a top-tier depository institution holding company are instruments issued by any inventory company that are qualifying capital instruments under paragraph (a)(1) of this section<sup>5</sup> and that meet all of the following criteria:

- (i) The holders of the instrument bear losses, as they occur, equally, proportionately, and simultaneously with the holders of all other qualifying capital instruments (other than additional tier 1 capital instruments or tier 2 capital instruments) before any losses are borne by holders of claims on the building block parent any with greater priority in a receivership, insolvency, liquidation, or similar proceeding.
- (ii) The paid-in amount would be classified as equity under GAAP.
- (iii) The instrument meets the criteria in §§ 217.20(b)(1)(i) through (vii) and 217.20(b)(1)(x) through (xiii).

(4) *Tier 2 capital instruments.* Tier 2 capital instruments of a top-tier depository institution holding company are instruments issued by any inventory company that are qualifying

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<sup>5</sup> For purposes of this paragraph (a)(3), the supervised insurance organization evaluates the criteria in paragraph (a)(1) of this section with regard to the building block in which the issuing inventory company is a member.

capital instruments under paragraph (a)(1) of this section and are not additional tier 1 capital instruments or common equity tier 1 capital instruments.

(b) *Determination of building block available capital.* (1) *In general.* For each building block parent, *building block available capital* means the sum of the items described in paragraphs (b)(1)(i) and (ii) of this section:

(i) The company available capital of the building block parent:

(A) Less the amount of downstreamed capital owned by any member of the building block parent's building block;<sup>6</sup> and

(B) Adjusted pursuant to paragraph (c) of this section;

(ii) For each downstream building block parent, the adjusted downstream building block available capital ( $BBAC_{ADJ}$ ), which is calculated according to the following formula:

$$BBAC_{ADJ} = (BBAC_{DS} - UpInv + ACSM) \cdot AS$$

Where:

(A)  $BBAC_{DS}$  is equal to the building block available capital of the downstream building block parent;

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<sup>6</sup> The amount of the downstreamed capital is calculated as the amount, excluding any impact on taxes, of the company available capital of the building block parent of the upstream building block, if the owner were to deduct the downstreamed capital.

(B) *UpInv* is equal to the amount of any upstream investment held by that downstream building block parent in the building block parent;<sup>7</sup>

(C) *ACSM* is equal to the appropriate available capital scaling modifier under § 217.606; and

(D) *AS* is equal to the building block parent's allocation share of the downstream building block parent.

(2) *Combining tiers of capital.* If there is more than one tier of company available capital under a building block parent's indicated capital framework, the amounts of company available capital from all tiers are combined in calculating building block available capital in accordance with paragraph (b) of this section.

(c) *Adjustments in determining building block available capital.* For purposes of the calculations required in paragraph (b) of this section, a supervised insurance organization must adjust the company available capital for any building block parent as follows:

(1) *Nonqualifying capital instruments.* A supervised insurance organization must deduct from the building block parent's company available capital any accretion arising from any instrument issued by any company that is a member of the building block parent's building block, where the instrument is not a qualifying capital instrument.

(2) *Insurance underwriting RBC.* When applying the U.S. federal banking capital rules as the indicated capital framework for a building block parent, a supervised insurance organization

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<sup>7</sup> The amount of the upstream investment is calculated as the impact, excluding any impact on taxes, on the downstream building block parent's building block available capital if the owner were to deduct the investment.

must add back into the building block parent's company available capital any amounts deducted pursuant to § .22(b)(3) of those rules.

(3) *Permitted accounting practices and prescribed accounting practices.* A supervised insurance organization must adjust the building block parent's company available capital by any difference between:

(i) The building block parent's company available capital; and  
(ii) The building block parent's company available capital recalculated under the assumption that neither the building block parent, nor any company that is a member of that building block parent's building block, had prepared its financial statements with the application of any permitted accounting practice, prescribed accounting practice, or other practice, including legal, regulatory, or accounting procedures or standards, that departs from a solvency framework as promulgated for application in a jurisdiction.

(4) *Adjusting certain life insurance reserves.* A supervised insurance organization must adjust the building block parent's company available capital by any difference between:

(i) The building block parent's company available capital; and  
(ii) The building block parent's company available capital recalculated based on using a 40 percent factor applied to all term life insurance accounted for using an approach based on the Valuation of Life Insurance Policies Model Regulation and a 90 percent factor is applied to all secondary-guaranteed universal life insurance products accounted for using Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation.

(5) *Deduction of investments in own capital instruments.*

(i) *In general.* A supervised insurance organization must deduct from the building block parent's company available capital any investment by the building block parent in its own capital instrument(s), or any investment by any member of the building block parent's building block in capital instruments of the building block parent, including any net long position determined in accordance with paragraph (c)(5)(ii) of this section, to the extent that such investment(s) would otherwise be accretive to the building block parent's building block available capital.

(ii) *Net long position.* For purposes of calculating an investment in a building block parent's own capital instrument under this section, the net long position is determined in accordance with § 217.22(h), provided that a separate account asset or associated guarantee is not regarded as an indirect exposure unless the net long position of the fund underlying the separate account asset (determined in accordance with § 217.22(h) without regard to this paragraph (c)(5)(ii)) equals or exceeds 5 percent of the value of the fund.

(6) *Reciprocal cross holdings in the capital of financial institutions.* A supervised insurance organization must deduct from the building block parent's company available capital any investment(s) by the building block parent in the capital of unaffiliated financial institutions that it holds reciprocally, where such reciprocal cross holdings result from a formal or informal arrangement to swap, exchange, or otherwise intend to hold each other's capital instruments, to the extent that such investment(s) would otherwise be accretive to the building block parent's building block available capital.

(d) *Limits on certain elements in building block available capital of top-tier depository institution holding companies.*

(1) *Investment in capital of unconsolidated financial institutions.* (i) A top-tier depository institution holding company must deduct from its building block available capital any accreted capital from an investment in the capital of an unconsolidated financial institution that is not an inventory company, that exceeds twenty-five percent of the amount of its building block available capital, prior to application of this adjustment, excluding tier 2 capital instruments. For purposes of this paragraph, the amount of an investment in the capital of an unconsolidated financial institution is calculated in accordance with § 217.22(h), except that a separate account asset or associated guarantee is not an indirect exposure.

(ii) The deductions described in this paragraph (d)(1) are net of associated deferred tax liabilities in accordance with § 217.22(e).

(2) *Adjustments to accretions from tier 2 capital instruments.* A top-tier depository institution holding company must adjust accretions from tier 2 capital instruments in accordance with this paragraph (d)(2).

(i) A top-tier depository institution holding company must deduct any accretions from tier 2 capital instruments that, in the aggregate, exceed the greater of:

(A) 150 percent of the amount of its building block capital requirement; and

(B) The amount of instruments subject to paragraphs (e) or (f) of this section that are outstanding as of the submission date; and

(ii) A top-tier depository institution holding company must increase accretions from tier 2 capital instruments by any amount deducted from accretions from additional tier 1 capital instruments by operation of paragraph (d)(3) of this section.

(3) *Limitation on additional tier 1 capital instruments.* A top-tier depository institution holding company must deduct any accretions from additional tier 1 capital instruments that, in the aggregate, exceed the greater of:

- (i) 100 percent of the amount of its building block capital requirement; and
- (ii) The amount of instruments subject to paragraph (f) of this section that are outstanding as of the submission date.

(e) *Treatment of outstanding surplus notes.* A surplus note issued by any company in a supervised insurance organization is deemed to meet the criteria in paragraphs (a)(1)(iii) and (vi) of this section if:

- (1) The instrument was issued prior to the later of—
  - (i) November 1, 2019; and
  - (ii) The earliest date on which any depository institution holding company in the group became a depository institution holding company;
- (2) The surplus note is a company capital element for the issuing company;
- (3) The surplus note is not owned by an affiliate of the issuer; and
- (4) The surplus note is outstanding as of the submission date.

(f) *Treatment of certain callable instruments.* Notwithstanding the criteria under paragraph (a)(1) of this section, an instrument with terms that provide that the instrument may be called earlier than five years upon the occurrence of a rating event does not violate the criterion in paragraph (a)(1)(v) of this section, provided that the instrument was a company capital

element issued prior to January 1, 2014, and that such instrument satisfies all other criteria under paragraph (a)(1) of this section.

*(g) Board approval of a capital instrument.*

(1) A supervised insurance organization must receive Board prior approval to include in its building block available capital for any building block an instrument (as listed in this section), issued by any company in the supervised insurance organization, unless the instrument:

(i) Was a capital element for the issuer prior to May 19, 2010, in accordance with the indicated capital framework that was effective as of that date and the underlying instrument meets the criteria to be a qualifying capital instrument (as defined in paragraph (a) of this section); or

(ii) Is equivalent, in terms of capital quality and ability to absorb losses with respect to all material terms, to a company capital element that the Board determined may be included in regulatory capital pursuant to paragraph (g)(2) of this section, or may be included in the regulatory capital of a Board-regulated institution pursuant to § 217.20(e)(3).

(2) After determining that an instrument may be included in a supervised insurance organization's regulatory capital under this subpart, the Board will make its decision publicly available, including a brief description of the material terms of the instrument and the rationale for the determination.

**PART 238 – SAVINGS AND LOAN HOLDING COMPANIES (REGULATION LL)**

8. The authority citation for part 238 continues to read as follows:

**Authority:** 5 U.S.C. 552, 559; 12 U.S.C. 1462, 1462a, 1463, 1464, 1467, 1467a, 1468, 5365; 1813, 1817, 1829e, 1831i, 1972, 15 U.S.C. 78l.

**Subpart P—Company-Run Stress Test Requirements for Savings and Loan Holding Companies**

9. In § 238.142:

- a. Revise paragraph (a)(1) introductory text; and
- b. Add paragraph (a)(3).

The revision and addition read as follows:

**§ 238.142      Applicability.**

(a)      \*      \*      \*

(1) *Applicability.* Except as provided in paragraphs (a)(3) and (b) of this section, this subpart applies to any covered company, which includes:

\*      \*      \*      \*      \*

(3) *Insurance savings and loan holding companies.* Notwithstanding any other provision of this paragraph (a), this subpart does not apply to a covered company that is subject to part 217, subpart J of this chapter.

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**PART 252 – ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)**

10. The authority citation for part 252 continues to read as follows:

**Authority:** 12 U.S.C. 321-338a, 481-486, 1467a, 1818, 1828, 1831n, 1831o, 1831p-1, 1831w, 1835, 1844(b), 1844(c), 3101 *et seq.*, 3101 note, 3904, 3906-3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

**Subpart F—Company-Run Stress Test Requirements for Certain U.S. Bank Holding Companies and Nonbank Financial Companies Supervised by the Board**

11. In § 252.53:

- a. Revise paragraph (a)(1) introductory text; and
- b. Add paragraph (a)(3).

The revision and addition read as follows:

**§ 252.53        Applicability.**

(a)        \*        \*        \*

(1) *Applicability.* Except as provided in paragraphs (a)(3) and (b) of this section, this subpart applies to any covered company, which includes:

\*        \*        \*        \*        \*

(3) *Insurance bank holding companies.* Notwithstanding any other provision of this paragraph (a), this subpart does not apply to a covered company that is a bank holding company that is subject to part 217, subpart J of this chapter.

\*        \*        \*        \*        \*

**By order of the Board of Governors of the Federal Reserve System.**

Ann E. Misback,  
*Secretary of the Board.*