October 10, 2019

Federal Reserve Proposes Regulatory Capital Framework for Insurance Depository Institution Holding Companies

FRB Issues Notice of Proposed Rulemaking to Establish Capital Requirements for Savings and Loan Holding Companies Significantly Engaged in Insurance

SUMMARY

The Board of Governors of the Federal Reserve System ("*FRB*") issued last month a notice of proposed rulemaking (the "*Proposal*") that would establish capital requirements for insurance groups that own depository institutions.[1] The proposed capital requirements would apply to any top-tier depository institution holding company that is itself an insurance underwriting company and to any top-tier depository institution holding company that, together with its subsidiaries, holds 25% or more of its total consolidated assets in insurance underwriting subsidiaries ("*insurance depository institution holding companies*" or "*IDIHCs*").

Building Block Capital Proposal

The proposed capital framework, termed the "Building Block Approach" ("*BBA*"), is designed to adjust and aggregate existing legal entity capital requirements into a consolidated capital framework for IDIHCs. The Proposal follows, and responds to comments received in connection with, the FRB's June 2016 advance notice of proposed rulemaking (the "*ANPR*") that proposed a conceptual version of a BBA.[2] The BBA constructs "building blocks" of entities in the company group that are covered under the same capital framework. The BBA would generally apply the capital framework applicable to a building block to the subsidiaries in that block, such that subsidiaries within an insurance building block would be subject to state insurance risk-based capital requirements and depository institution building blocks would be subject to federal bank regulatory capital requirements. After identifying all the building blocks and their applicable

capital frameworks, available capital and capital requirements would be determined for each building block, subject to proposed adjustments. Available capital and capital requirements would then be aggregated and translated by means of so-called "scalars" into the common capital framework for the BBA, which would be the Risk-Based Capital framework ("*RBC*") promulgated by the National Association of Insurance Commissioners ("*NAIC*"). The FRB proposes to use historical bank and insurer default data to construct an approach that uses probabilities of default to translate bank regulatory capital requirements into the common RBC capital framework, using scalars. The FRB published a white paper in conjunction with the Proposal explaining its proposed scaling framework and methodology.[3] At the top-tier enterprise level, the ratio of the amount of available capital to the capital requirement amount, called the BBA ratio, would be subject to a proposed minimum of 250%. In addition, the FRB proposes to establish a "capital conservation buffer" to limit capital distributions and discretionary bonus payments of IDIHCs that do not hold sufficient capital to satisfy the buffer. The proposed capital conservation buffer is 235% and would be in addition to the amount necessary to meet the proposed 250% minimum BBA ratio, for a total requirement of at least 485%. The FRB does not propose to apply FRB-run stress tests to IDIHCs at this time.

Section 171 Capital Proposal

The FRB also proposes a separate risk-based capital requirement for IDIHCs, which would exclude insurance activities, to address requirements under Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*"). Section 171 of Dodd-Frank provides that risk-based and leveraged capital requirements for depository institution holding companies may not be less than the "generally applicable" capital requirements for insured depository institutions ("*IDIs*"), nor quantitatively lower than the capital requirements that applied to IDIs as of the enactment of Dodd-Frank in July 2010. Section 171 also provides the FRB flexibility in developing consolidated capital requirements for IDIHCs by permitting the FRB to exclude certain insurance companies regulated by a state or foreign insurance regulator.

Under the proposed Section 171 calculation, the FRB's existing minimum risk-based capital requirements that are currently applied to bank holding companies and "covered savings and loan holding companies" (which exclude IDIHCs), would generally be applied to a top-tier IDIHC on a consolidated basis when the IDIHC is not itself an insurance underwriting company. In the case of an IDIHC that is itself an insurance underwriting company, the Section 171 requirements would instead apply to the farthest upstream non-insurer mid-tier depository institution holding company. Under the proposal, an IDIHC that is not itself an insurance underwriting company could elect not to consolidate the assets and liabilities of its subsidiary state or foreign insurance company subsidiaries for purposes of the Section 171 calculation. The proposal presents two alternative approaches with regard to the regulatory capital treatment of an IDIHC's equity investment in insurance subsidiaries that are not consolidated pursuant to a Section 171 election. The FRB is not currently proposing a minimum leverage requirement to be imposed on IDIHCs for purposes of compliance with the minimum leverage capital requirements required under Dodd-Frank Section 171. The

FRB notes, however, that it is continuing to evaluate methodologies to apply leverage requirements to IDIHCs.

The Proposal would not affect the current regulatory capital treatment of assets and liabilities associated with insurance subsidiaries of depository institution holding companies that are not IDIHCs.

Comment Process and Quantitative Impact Study

The FRB has posed 36 discrete questions in the Proposal on which it seeks comment. Comments on the Proposal will be due 60 days following its publication in the Federal Register. The FRB also intends to conduct a quantitative impact study of the BBA as part of its rulemaking process.

BACKGROUND

Dodd-Frank

Dodd-Frank expanded the FRB's supervisory role beyond bank holding companies ("*BHCs*") by transferring from the Office of Thrift Supervision (which was eliminated under Dodd-Frank) to the FRB primary supervisory responsibility over savings and loan holding companies ("*SLHCs*") and their non-depository subsidiaries, including over SLHCs significantly engaged in insurance activities (*i.e.*, IDIHCs). The FRB supervised 11 IDIHCs, consisting primarily of mutual insurers owning savings and loan depository institutions, as of its last Supervision and Regulation Report.[4] Under Title I of Dodd-Frank, the FRB was also given supervisory responsibility over any non-bank financial companies designated as systemically important by the Financial Stability Oversight Council ("*SIFIs*"), including SIFIs primarily engaged in insurance activities ("*Insurer SIFIs*"). No firms are currently designated as SIFIs.[5]

Section 171 of Dodd-Frank requires the FRB and other federal banking agencies to establish minimum risk-based and leverage capital requirements on a consolidated basis for all IDIs, BHCs, SLHCs and SIFIs. Subject to certain exceptions, Section 171 provides that these minimum risk-based and leverage capital requirements may not be less than those established for IDIs under the "prompt corrective action" regulations implementing Section 38 of the Federal Deposit Insurance Act. In addition, these risk-based and leverage capital requirements may not be "quantitatively lower" than the generally applicable risk-based or leverage capital requirements in effect on the date of enactment of Dodd-Frank (July 21, 2010).[6]

In December 2014, the Insurance Capital Standards Clarification Act (the "*Clarification Act*") was enacted, which provides that, in establishing the minimum risk-based and leverage capital requirements mandated under Section 171, the FRB is not required to include (including in any determination of consolidation) entities regulated by a state or foreign insurance regulator to the extent such entities act in their capacity as regulated insurance entities. The Clarification Act was intended to provide the FRB flexibility when developing consolidated capital requirements for FRB-supervised insurance groups. The Clarification Act further provides that the FRB may not require an IDIHC or Insurer SIFI that is also regulated by a state insurance regulator and files financial statements utilizing only Statutory Accounting Principles in accordance with state law ("*SAP*")[7] to prepare financial statements in accordance with U.S. Generally Accepted Accounting Practices ("*GAAP*"). Certain IDIHCs are mutual insurance companies that are not publicly traded and prepare and file their financial statements based solely on SAP.

U.S. Developments

The FRB published the ANPR on June 3, 2016. The ANPR described at a conceptual level two potential regulatory capital frameworks for FRB-supervised insurers. The first capital framework, referred to as the "building block approach" and intended for IDIHCs, would use, as a starting point, existing state and foreign risk-based capital requirements for insurance company subsidiaries, and the FRB's bank risk-based capital standards for banking, non-insurance and unregulated subsidiaries. The second capital framework, referred to as the "consolidated approach" and intended for Insurer SIFIs, would "categorize an entire insurance firm's assets and insurance liabilities into risk segments, apply appropriate risk factors to each segment at the consolidated level, and then set a minimum ratio of required capital."[8] The consolidated approach would use risk weights and risk factors determined by the FRB to be appropriate for the longer-term nature of most insurance liabilities and would be U.S. GAAP-based, subject to certain adjustments for regulatory purposes. According to the Proposal, the FRB continues to evaluate a capital requirement for Insurer SIFIs, and none is included in the Proposal.

In 2016, the NAIC formed a working group to develop a Group Capital Calculation using an RBC aggregation methodology (the "*GCC*"). The GCC is intended to be applied to insurance groups that include a U.S. insurance company and to provide additional analytical information to the lead U.S. state insurance regulator for use in assessing group risks and capital adequacy to complement current U.S. insurance holding company laws. The GCC is not intended to impose a minimum group-level capital requirement on insurance holding companies subject to it.

According to the Proposal, FRB staff solicited views of the NAIC and state insurance regulators on the overall development of the BBA, in part in order to achieve consistency between the GCC and BBA where possible and to minimize burdens on firms that may be subject to both frameworks.

International Developments

Passage of Dodd-Frank and related rulemakings in the United States occurred at generally the same time as financial regulatory reform initiatives at the international level, including efforts to reform global insurance regulation and develop group-wide insurance capital frameworks. For example, in the European Union ("*EU*"), the Solvency II Directive (2009/138/EEC) ("*Solvency II*"), which became effective on January 1, 2016, includes minimum capital and solvency requirements, governance requirements, risk management and public reporting standards applicable to insurers operating in the EU, as well as group-wide supervision and solvency standards. These standards may be applied to insurance groups that are headquartered outside the EU but that have EU operations.

In addition, the International Association of Insurance Supervisors ("*IAIS*") is in the process of developing several international capital and supervisory standards that are expected, when finalized, to be implemented by member jurisdictions (including the United States). As part of its efforts to create a common framework for the supervision of "internationally active insurance groups" ("*IAIGs*"), the IAIS began work on a comprehensive, group-wide international insurance capital standard (the "*ICS*") in 2013 to be applied to IAIGs. In 2017, the IAIS decided to release the ICS in two phases: a five-year monitoring phase beginning in 2020, during which the ICS would be reported on a confidential basis to group-wide supervisors (the Monitoring Period), followed by an implementation phase. The IAIS is planning to complete and release ICS Version 2.0 for use in the Monitoring Period in 2019. The ICS as currently proposed is comprised of a market-adjusted valuation approach (MAV), which is a market-based balance sheet valuation approach similar to that used under the Solvency II framework, along with a standard method for determining capital requirements and common criteria for available capital. At the option of an IAIG's group-wide supervisor, ICS 2.0 will also include an alternative valuation approach that is based on local GAAP accounting rules with certain adjustments to produce results that are comparable to the MAV-based ICS.

The Proposal states that the "ICS may not be optimal for the Board's supervisory objectives, considering the risks and activities in the U.S. insurance market" and indicates that the BBA, as opposed to the ICS, "would appropriately reflect, rather than unduly penalize, long-duration insurance liabilities in the United States." The FRB, along with the NAIC, state insurance regulators, and the Federal Insurance Office, have been advocating in international forums such as the IAIS for development of an aggregation method akin to the BBA and the GCC that can be deemed an outcome-equivalent approach for implementation of the ICS.[9]

BUILDING BLOCK APPROACH

The proposed BBA is an approach to a consolidated capital requirement that aims to consider all material risks on an enterprise-wide basis by aggregating the capital positions of companies under an IDIHC after expressing them in terms of the NAIC's RBC framework. The BBA constructs "building blocks"—or groupings of entities in the supervised firm—that are covered under the same capital framework. These building blocks are then used to calculate the combined, enterprise-level available capital and capital requirement. "Available capital" refers to loss-absorbing capital that qualifies for use as capital under a regulatory capital framework and "capital requirement" refers to a measurement of the loss-absorbing resources a firm needs to maintain commensurate with its risks. Ultimately, all of the building blocks are aggregated into the top-tier IDIHC's building block, thereby resulting in an amount of available capital and capital requirement for the IDIHC which is then used to calculate its BBA ratio. The proposed BBA regulations would amend the FRB's existing Regulation Q, primarily by adding a new Subpart J specific to IDIHCs.[10]

A. SCOPE

The Proposal as written would not apply to BHCs or Insurer SIFIs, though the FRB would retain the right to apply the BBA to other entities by order (explicitly including Insurer SIFIs). The Proposal indicates that the FRB "anticipates harmonizing the regulation of BHCs and SLHCs significantly engaged in insurance activities" and that the final BBA rule may address the application of the BBA to BHCs significantly engaged in insurance activities.

An SLHC would be significantly engaged in insurance activities, and thus subject to the BBA, if: (1) the top-tier depository institution holding company is an insurance underwriting company; (2) the top-tier depository institution holding company, together with its subsidiaries, holds 25% or more of its total consolidated assets in insurance underwriting subsidiaries (other than assets associated with insurance underwriting for credit risk); or (3) the firm has otherwise been made subject to the BBA by the FRB. For purposes of the 25% threshold, a supervised holding company would be required to calculate 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 securities laws), the firm could estimate its total consolidated assets, subject to review and adjustment by the FRB.

Any entities not owned or controlled by the top-tier SLHC (such as sister companies) and that do not own or control any IDIs would not be included in the BBA calculations. The FRB further acknowledges that in some instances it would be "more practical and efficient" to treat a mid-tier entity as the top-tier SLHC; the FRB reserves the right to order such treatment as it deems appropriate in the Proposal.

B. IDENTIFICATION OF BUILDING BLOCKS AND BUILDING BLOCK PARENTS

Inventory

The first step in identifying the building block and building block parents would be establishing the universe of entities to be assigned to building blocks, the "inventory companies." To do this, an IDIHC would be required to conduct an inventory of all companies in its enterprise, which would include each company that appears on FRB Forms FR Y-6 or FR Y-10, or is listed as an affiliate on the NAIC's Schedule Y that is filed annually as part of SAP financial statements.

The Proposal further provides that any company, special purpose entity, variable interest entity or similar entity that is not listed on Forms FR Y-6, FR Y-10 or NAIC Schedule Y would be deemed an inventory company if the entity: (1) enters into one or more reinsurance or derivative transactions with other inventory companies; (2) is "material" as defined in the Proposal (discussed further below); (3) is engaged in activities such that one or more inventory companies are expected to absorb more than 50% of its expected losses; or (4) is otherwise identified by the FRB as an inventory company. However, an IDIHC is not required to assign to a building block any inventory company that is not a downstream company or subsidiary of a top-tier IDIHC, and thus such inventory companies would not be considered for the BBA ratio.

Applicable Capital Framework

Once the inventory of companies is complete, the next step would be to identify the building block parents, whose applicable capital framework would apply to their building blocks. The applicable capital framework of an identified building block parent would be used to reflect the capital position of all the subsidiaries within the building block, including subsidiaries that may not be directly subject to any regulatory capital framework.

The applicable capital framework for an insurance building block parent would generally be the regulatory capital framework it is subject to. For instance, the applicable capital framework for U.S. insurance companies would be the RBC framework for life insurers, fraternal insurers, health insurers, or property and casualty insurers, as applicable, based on the company's primary source of premium revenue. For material insurance companies that lack a regulatory capital framework for which scaling can be performed under the BBA, the FRB proposes to apply RBC after restating such companies' financial information according to SAP. The Proposal identifies captive insurance companies as a candidate for such treatment. The capital framework applicable to non-insurance "material financial entities" (as defined and discussed further below) would depend on the regulatory capital framework such entities are subject to and whether such framework is scalar-compatible. The FRB proposes to apply a modified version of the FRB's bank regulatory capital rule to IDIHCs predominantly engaged in title insurance due to the absence of an RBC capital framework that is applied to title insurance companies. According to the Proposal, there is currently only one such IDIHC, and it prepares U.S. GAAP financials as a public company, which, the FRB notes, should make the application of the FRB's bank regulatory capital rule less burdensome.

With respect to insurance subsidiaries subject to non-U.S. capital frameworks, the Proposal indicates that the current population of IDIHCs does not include material non-U.S. operations, and proposes that whether any non-U.S. insurance companies are identified as building block parents would depend on whether their applicable capital frameworks can be scaled to RBC.

For IDI building block parents, the capital framework is the applicable federal bank regulatory capital rule, such that for nationally chartered IDIs, the applicable capital framework is the capital rule as set forth by the Office of the Comptroller of the Currency; for state-chartered IDIs that are members of the Federal Reserve System, the FRB's bank regulatory capital rule; and for those that are not members, the capital rule as set forth by the Federal Deposit Insurance Corporation.

Building Block Parents

The Proposal categorizes several types of companies that could potentially be a building block parent. In the first place, the top-tier IDIHC would be a building block parent containing all the IDIHC's subsidiaries. Any mid-tier holding company that is a "depository institution holding company" under U.S. law ("*DIHC*") would also automatically be identified as a building block parent. Capital-regulated companies ("*CRCs*"), *i.e.*, companies such as U.S. insurance subsidiaries that are subject to company-level regulatory capital requirements, and material financial entities ("*MFEs*"), which are material non-CRCs, *e.g.*, captive reinsurance subsidiaries and derivatives trading subsidiaries, are two other types of potential building block parents. For CRCs and MFEs, the IDIHC would analyze whether that company's applicable capital framework differs from that of the next CRC or MFE encountered when proceeding upstream in the IDIHC's inventory. If its capital framework differs from the next upstream company, the CRC or MFE would be identified as a building block parent.

If the capital framework of a CRC or MFE is the same as the next upstream company, the company would generally remain in the same building block. However, where a parent company's capital framework treats the company's subsidiaries in a way that does not substantially reflect the subsidiary's risk (the Proposal provides as an example the case of a foreign subsidiary that assumes risks from affiliates), the subsidiary CRC or MFE would itself be identified as a building block parent. The FRB explains that this approach is intended to result in the CRC's or MFE's risks being appropriately reflected in the BBA.

With respect to foreign CRCs, if a scalar has been developed for translating the foreign CRC's capital framework into RBC, the foreign CRC would be identified as a building block parent. Where a scalar has not been developed, but the aggregate of the IDIHC's subsidiaries subject to the non-U.S. insurance capital framework is material, the BBA proposes a provisional scaling approach that could result in such companies being identified as building block parents. In all other cases, it would appear that non-U.S. insurance CRCs would not be identified as building block parents, although the Proposal does not fully address the treatment of material non-U.S. CRCs and the potential scaling thereof, as the FRB has determined that the IDIHCs currently subject to its supervision do not have any material non-U.S. subsidiaries.

An MFE would be defined as a financial entity[11] that, together with its subsidiaries (but excluding any subsidiary CRC or subsidiary thereof), is "material," subject to certain exceptions. The proposed definition of "material" has two parts: (1) a company is presumed to be material if the top-tier IDIHC has exposure to the company exceeding 1% of the IDIHC's total assets,[12] where "exposure" is defined to include the IDIHC's direct or indirect interest in the company's capital, any explicit or implicit guarantee "for the benefit of the company" from the IDIHC or its subsidiaries, or potential counterparty credit risk to the IDIHC or its subsidiaries from derivatives, reinsurance or other contractual arrangements; and (2) a company would be considered material if it is otherwise significant in assessing the IDIHC's available capital and required capital based on risk exposure, affiliate guarantees, size and other specified factors. According to the Proposal, examples of MFEs include a material derivatives trading subsidiary, a funding vehicle for borrowing and downstreaming funds to affiliates, and captive reinsurance subsidiaries.

The BBA would allow an IDIHC to not treat as MFEs certain companies that otherwise meet the definition of MFE. This election is available for inventory companies that function solely as intermediaries for the transfer of risk from affiliates to third parties or for investment activities conducted by affiliates. If the election is made, the IDIHC would be required to allocate the relevant company's risks to other companies within the enterprise. In addition, financial subsidiaries as defined under Section 121 of the Gramm-Leach-Bliley Act[13] and registered investment advisors are ineligible to be MFEs, and thus would presumably be subsumed under the capital framework applicable to their nearest upstream building block parent.

In addition to DIHCs, CRCs and MFEs, the BBA would allow for three other cases in which a company may be identified as a building block parent. In the first case, a company would be a building block parent if it: (1) enters into one or more reinsurance or derivative transactions with other inventory companies; (2) is "material" (as defined above); and (3) is engaged in activities such that one or more inventory companies are expected to absorb more than 50% of its expected losses. In the second case, where a company is jointly owned by more than one building block parent but is not itself otherwise a building block parent, the BBA would identify the jointly owned company as a building block parent so as to avoid double-counting of risks and resources, subject to the calculation of allocation shares discussed below. In the third case, the BBA would provide a reservation of authority for the FRB, whereby the FRB may require the IDIHC to identify any company as a building block parent or MFE; the FRB's reservation of authority would also permit it to reverse the identification of a building block parent or MFE.

Aggregation

After the building block parents are identified, each inventory company that is not a building block parent would be assigned to the building block of any building block parent that owns a company capital element[14] of the inventory company in question or of which the inventory company is a subsidiary.[15] This could result in an inventory company being assigned to multiple building blocks, and the BBA would include a mechanism intended to prevent double-counting.

The BBA's approach to aggregation would proceed from the bottom up, and would require establishing the available and required capital of each of the building blocks, which would be aggregated to determine the available and required capital of the IDIHC on a consolidated basis. In order to avoid double-counting, the capital requirement and available capital of the building block parent would be calculated first on the assumption that members of the building block have no investment in any downstream building block parent, and then a portion of each downstream building block parent's available and required capital would be added (after any necessary scaling if the capital framework requires it). The BBA's mechanism to prevent double-counting would entail determining a building block parent's "allocation share" of any downstream building block parent and aggregating capital requirements and available capital by applying the appropriate allocation shares involved. The BBA would provide for a formula to calculate an upstream building block parent's allocation share of a downstream building block parent where the downstream building block parent is owned in different proportions by two or more upstream building block parents, or the capital elements of which (*e.g.*, surplus notes) are held by different upstream building block parents.

C. SCALING

"Scaling" is the term used in the Proposal for translating a company's capital position under one capital framework to its equivalent capital position under another framework. In the Proposal as it stands, it is used primarily for translating U.S. federal bank capital positions into NAIC RBC capital positions. The FRB has determined that none of the current IDIHCs have material non-U.S. insurance subsidiaries, and thus the FRB is not proposing scaling for non-U.S. insurance capital frameworks.[16]

The White Paper discusses several methods that were considered for establishing the scalars between federal bank regulatory capital and RBC rules. The method chosen is the "Historical Probability of Default" method, which establishes equivalence between capital positions in different frameworks by using logistic regressions of historical data on default rates to find the capital positions that produced the same or similar rates of default.

Using the probability of default approach, the key scalars in the Proposal include:

- NAIC Authorized Control Level ("*ACL*") RBC, which represents the RBC capital requirement, would be determined for a bank capital position by multiplying the IDI's bank-regulatory risk-weighted assets by 0.016
- NAIC Total Adjusted Capital ("*TAC*"), which represents the RBC available capital, would be determined for a bank capital position by subtracting from the IDI's bank regulatory total capital the product of risk-weighted assets and 0.063.

Scaling available capital from bank regulatory capital rules to insurance RBC rules would require combining common equity tier 1, additional tier 1, and tier 2 capital under the FRB's bank regulatory capital rule because there is only one tier of capital in NAIC RBC and the BBA (as discussed below).

Where scalars have been provided by the FRB, it would be a straightforward process to scale between the two frameworks by multiplying the capital position of the relevant building block by the scalar indicated by the table in the Proposal, with the product of the calculation being equivalent to the capital position in the other capital framework.

Although the FRB is not proposing fixed scalars beyond those to be applied between federal bank regulatory capital positions and RBC capital positions, the Proposal includes a framework by which scaling would be provisionally determined for a capital framework where no scalar is specified. The provisional approach would be used for a non-U.S. insurance subsidiary when its regulatory capital framework is "scalar-compatible" until such time as the FRB specifies a fixed scalar for the capital framework. A scalar-compatible framework is defined as a framework that is clearly defined and broadly applicable to companies engaged in insurance, has an identifiable intervention point that can be used to calibrate a scalar, and provides a risk-sensitive measure of required capital reflecting material risks to a company's financial strength.[17] Where the non-U.S. insurance subsidiary's regulatory capital framework is not scalar-compatible, the BBA would apply NAIC RBC to the company.

D. AGGREGATION OF BUILDING BLOCK REQUIRED CAPITAL

To determine the capital requirement of the IDIHC, the capital requirements of the building blocks would be aggregated after they have all been scaled to the common framework (*i.e.*, the NAIC RBC framework). The proposed BBA would determine aggregate capital requirements by beginning with the capital requirements at each building block. For building block parents that are subject to NAIC RBC, the FRB proposes to use the ACL amount of required capital under NAIC RBC as the input to aggregation. For building block parents subject to the FRB's bank regulatory capital rule, the FRB proposes using total risk-weighted assets as the input to aggregation. The BBA would aggregate a downstream building block's capital requirements into those of its upstream building block parent by scaling to the upstream parent's capital framework and adding to the upstream parent's capital requirement. This rollup includes adjusting for the parent's ownership of the building block prior to adding in the scaled capital requirement for the building block. Ultimately, all building block capital requirements would be scaled and rolled up into the capital requirement of the top-tier IDIHC. However, before capital requirements are aggregated, the Proposal provides for several adjustments, summarized below.

Permitted and prescribed practices. Insurance company accounting practices can vary between states, and deviate from NAIC SAP requirements, on account of permitted or prescribed accounting practices by individual states (so-called "*permitted and prescribed practices*"). The BBA proposes to adjust capital requirements of building blocks by reversing permitted and prescribed practices (and, if relevant, any approved practices that deviate from the capital framework applicable to non-U.S. insurance subsidiaries).

Intercompany transactions. As intercompany transactions would not be eliminated in an aggregation method such as the BBA, the FRB expresses concern in the Proposal that non-eliminated intercompany transactions may overstate or understate risks, depending on the intercompany transaction. In particular, "intra-group reinsurance, loans, or guarantees can result in credit risk weights at the subsidiary level without generating additional risk at the enterprise level." The BBA would include an adjustment that would reverse the capital effects of "capital requirements related to potential for the possibility of default" of the top-tier IDIHC or any of its subsidiaries. This adjustment appears intended to address what the FRB sees as a potential misstatement of enterprise-wide risk in light of the fact that intercompany transactions are not eliminated. However, because the FRB believes that "the impact on enterprise-wide capital requirements from this reflection of risk may be small or immaterial," the FRB states in the Proposal that "this adjustment would be optional under the proposal, *i.e.*, allowing the insurance depository institution holding company the option to eliminate the credit risk weight in capital requirements at one company party to the intercompany transaction."[18]

Transitional measures. The BBA would include an adjustment to remove the effects of any transitional or grandfathering measures under an applicable capital framework. The Proposal indicates as an example that this could be significant for U.S. insurance companies that are subject to principles-based reserving ("*PBR*"), since the adjustment would require an insurer to accelerate the full application of PBR, which is currently subject to various transitional measures (as full implementation of PBR standards is to become effective on January 1, 2020, this may not have a meaningful impact).

Intermediary companies. As noted above, the BBA would permit an IDIHC to elect not to treat as MFEs certain pass-through or risk management intermediary companies that would otherwise meet the definition of MFE. If the election is made, the risks posed by the company should still be reflected in the BBA. Accordingly, the BBA would require the IDIHC to allocate the risks borne by the pass-through or risk intermediary company to other inventory companies with which the company engages in transactions.

Title companies. For IDIHCs predominantly engaged in title insurance, which as noted above would be subject to the FRB's bank regulatory capital rule, the FRB proposes to adjust capital requirements by applying a risk weight of 300% to the firm's claim reserves relating to title insurance business, as reflected in the firm's GAAP financial statements.[19]

E. AGGREGATION OF BUILDING BLOCK AVAILABLE CAPITAL

Unlike the FRB's bank regulatory capital rule, in which qualifying capital is divided into tiers, the proposed BBA on its face contains only one tier of available capital. Indeed, NAIC RBC, the common capital framework for the BBA, only uses one tier of available capital for purposes of determining TAC. However, as discussed further below and notwithstanding the purported use of only one tier of available capital, the BBA would limit, at the level of the top-tier IDIHC's available capital, certain capital instruments (called "*tier 2 capital instruments*") to no more than 62.5% of the top-tier IDIHC's capital requirement.

As with capital requirements, the BBA would determine total available capital by aggregating available capital under the capital frameworks applicable to the various building blocks. This would be achieved by rolling up available capital from downstream building block parents into upstream building block parents, subject to certain adjustments and scaling. According to the Proposal, the aggregation of available capital would eliminate double leverage or multiple leverage by deducting upstream parents' investments in subsidiaries that are building block parents.[20] In addition, the Proposal requires an IDIHC to deduct upstream holdings within a building block, *i.e.*, an investment by a subsidiary of a building block parent in the parent's capital instrument.

The Proposal provides for several adjustments before available capital is aggregated, as summarized below. Certain final adjustments would then be made at the level of the top-tier IDIHC once all building block available capital has been aggregated, as described further below.

Qualifying capital instruments. The BBA proposes to deduct from available capital any capital instrument issued by a building block company that does not include one or more specified features that a capital instrument must have in order to qualify as capital for a building block, largely following existing bank regulatory capital requirements. Under the Proposal, a capital instrument would be required to meet the following criteria in order to qualify as available capital for purposes of the BBA:

- the instrument is issued and paid-in;
- the instrument is subordinated to depositors and general creditors of the building block parent;
- the instrument is not secured, guaranteed or otherwise credit-enhanced;
- 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 eligible to be included in capital must be reduced by 20%; 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 (an instrument that by its terms automatically converts into a qualifying capital instrument prior to five years after issuance will comply with the five-year maturity requirement);
- the instrument may be called by the building block parent only after a minimum of five years following issuance; in addition: (1) the top-tier IDIHC must receive the FRB's prior approval to exercise a call option on the instrument; (2) the building block parent must not create an expectation that the call option will be exercised; and (3) prior to exercising the call option, or immediately thereafter, the IDIHC must either replace the capital or demonstrate to the FRB that remaining capital is adequate;[21]
- redemption of the instrument prior to maturity or repurchase requires the prior approval of the FRB; and
- the instrument must meet certain criteria in the bank regulatory capital requirements (*e.g.*, the holder must have no right to accelerate except upon default and the instrument cannot have a rate that fluctuates based on the institution's credit standing).

Based on prior guidance regarding analogous requirements in the bank regulatory capital rules, the qualifying criterion that redemption or repurchase requires prior approval from the FRB would be interpreted and applied to require prior supervisory approval for any repurchase or redemption of a capital instrument, including common stock.[22]

Surplus notes. As a general matter, surplus notes issued by insurers are eligible for inclusion in available capital under the BBA as long as the notes meet the foregoing criteria for qualifying capital.[23] In addition, the BBA proposes to grandfather surplus notes issued prior to November 1, 2019 as available capital, provided the surplus note currently counts as capital under applicable state insurance capital frameworks. Future surplus note issuances, however, would be required to comply with all qualifying capital requirements in order to count as available capital.

Insurance underwriting risk capital. With respect to certain CRCs that are subject to federal bank regulatory capital rules, the FRB's bank regulatory capital rule currently deducts from the available capital of a DIHC the NAIC RBC requirement for insurance underwriting risk of the DIHC and its subsidiaries. This deduction would be eliminated in calculating building block available capital since the insurance risks are being aggregated, and such deductions could overly penalize an IDIHC.

Permitted and prescribed practices. Similar to the adjustment for capital requirements, the BBA would reverse the impact of permitted and prescribed accounting practices.

Transitional measures. Similar to the adjustment for capital requirements, the BBA would remove the effects of any grandfathering or transitional measures in determining available capital.

Investments in own capital instruments. The BBA would require building block parents to deduct the amount of their investments in their own capital instruments along with any investments in the parent's own capital made by members of its building block, to the extent such instruments are not already excluded from available capital. A capital instrument issued by a company in an IDIHC's enterprise that the firm could be contractually obligated to purchase also would be deducted from available capital. The Proposal further requires an IDIHC to look through its holdings of index securities to deduct investments in its own capital instruments, including synthetic exposures related to investments in its own capital instruments, generally as calculated pursuant to federal bank regulatory capital rules. Gross long positions in investments in its own capital instruments resulting from holdings of index securities would be netted against short positions in the same underlying index, although if it would be operationally burdensome to look through its holdings of index securities, the BBA would permit the IDIHC to use a conservative estimate of its holdings of its own capital instruments through index securities with prior approval from the FRB. Otherwise, gross long positions would be allowed to be deducted net of short positions in the same underlying instrument only if the short positions involve no counterparty risk. The BBA would exclude positions held in a separate account asset or through an associated guarantee, unless the relevant separate account fund is concentrated in the company.

Reciprocal cross-holdings. Reciprocal cross-holdings relate to a formal or informal arrangement between two financial institutions to swap, exchange, or otherwise hold or intend to hold each other's capital instruments. Under the Proposal, reciprocal cross-holdings of capital instruments of companies within an IDIHC would be deducted from available capital.

With respect to final adjustments to be made at the level of the top-tier IDIHC once all building block available capital is aggregated:

Investments in unconsolidated financial institutions. The FRB proposes to limit available capital under the BBA from investments in the capital of unconsolidated financial institutions in a manner consistent with the capital deductions under the FRB's bank regulatory capital rules. In order to operationalize the limitation and account for IDIHCs that do not prepare consolidated GAAP financials, the Proposal would include a proxy for consolidation. Within the proposed framework, a top-tier IDIHC would be required to deduct from available capital any accreted capital from an investment in the capital of an unconsolidated financial institution that is not an inventory company and that exceeds 25% of the amount of its total available capital (excluding tier 2 capital instruments). Investments in the capital of unconsolidated financial institutions would be determined as the net long position calculated in accordance with federal bank regulatory capital rules (*i.e.*, following the procedures described above for investments in own capital) regarding threshold deductions for investments in capital instruments in unconsolidated financial institutions, except that separate account assets and associated guarantees would not be treated as an indirect exposure. Accordingly, the look-through treatment in the bank regulatory capital rule would not be applied to separate account assets or associated guarantees.

Additional limit on tier 2 capital instruments. Although the criteria for qualifying capital described above establish a "baseline threshold" for capital instruments to be included as available capital under the BBA, the FRB proposes a limit to the amount of available capital at the group-IDIHC level consisting of capital instruments the FRB considers to be of lower quality or loss-absorbing capability. The BBA would define "tier 2 capital instruments" as instruments issued by any inventory company that are qualifying capital instruments in accordance with the criteria above, other than those qualifying capital instruments that meet all of the following criteria:

- the holders of the instruments bear losses as they occur equally, proportionately, and simultaneously with the holders of all other qualifying capital instruments (other than tier 2 capital instruments) before any losses are borne by holders of claims on the top-tier IDIHC with greater priority in a receivership, insolvency, liquidation, or similar proceeding;
- the paid-in amount would be classified as equity under GAAP; and
- the instrument meets certain specified criteria under the FRB's bank regulatory capital rules (*e.g.*, instruments satisfying the criteria for common equity tier 1 capital, retained earnings, and other elements of surplus).

Under the Proposal, tier 2 capital instruments must represent no more than 62.5% of the *capital requirement* (as opposed to available capital) for the top-tier IDIHC. According to the FRB, an IDIHC holding exactly the minimum requirement level of available capital would therefore hold at least 187.5% of the top-tier IDIHC's minimum capital requirement through available capital other than tier 2 instruments. Because the capital conservation buffer may only be satisfied by available capital other than tier 2 instruments, the effective minimum requirement would be 485%, with at least 422.5% of the top-tier IDIHC's minimum capital requirement held as instruments other than tier 2 instruments.

Approval of additional capital elements. The BBA provides that the IDIHC must receive prior FRB approval for including as available capital any instrument issued by an inventory company unless the instrument was a company capital element for the issuer prior to May 19, 2010, or is equivalent in terms of capital quality and ability to absorb losses to a company capital element that is included in regulatory capital under the Proposal or the FRB's bank regulatory capital rules.

F. BBA RATIO, MINIMUM CAPITAL REQUIREMENT AND CAPITAL CONSERVATION BUFFER

Under the BBA, the minimum capital requirement for an IDIHC would be the ratio of aggregated building block available capital to the aggregated building block capital requirement (the "*BBA Ratio*"). The Proposal would require a minimum BBA Ratio of 250%, determined by translating the 8% minimum total capital requirement of risk-weighted assets under the FRB's bank regulatory capital rule to its NAIC RBC equivalent, and then adding a margin of conservatism.

The Proposal also includes a capital conservation buffer of 235%, the translated amount of the capital conservation buffer in the FRB's bank regulatory capital rules, applied on a calendar-year basis rather than quarterly because of the proposed annual reporting cycle for the BBA. An IDIHC would need to hold a capital conservation buffer in an amount greater than 235% (which, together with the minimum BBA Ratio requirement of 250%, results in a total requirement of at least 485%) to avoid limitations on capital distributions and discretionary bonus payments to executive officers.

For companies holding less capital than the capital conservation buffer mandates, the Proposal provides for a maximum dollar amount (calculated as a maximum payout ratio multiplied by eligible retained income) that the IDIHC could pay out in the form of capital distributions ("distributions" is defined to include discretionary dividends on participating insurance policies as such payments are equivalent to stock dividends for mutual insurers) or discretionary bonus payments during a calendar year.[24] An IDIHC with a buffer of more than 235% would not be subject to a maximum payout amount, subject to other regulatory limitations outside the BBA that might be applicable.

The capital conservation buffer is restricted to available capital excluding tier 2 instruments, which is similar to the way the capital conservation buffer under the FRB's bank regulatory capital rules is restricted to common equity tier 1 instruments.

According to the Proposal, based on the FRB's preliminary review, the FRB does not anticipate that any currently supervised IDIHC would initially need to raise capital to meet the requirements of the BBA, including the capital conservation buffer.

G. REPORTING FORM AND DISCLOSURE REQUIREMENTS

The FRB proposes to implement a new annual reporting form, "Capital Requirements for Board-Regulated Institutions Significantly Engaged in Insurance Activities" (Form FR Q-1), for the BBA, and of the information reported on that form, proposes to make public only the building block available capital, building block capital requirement, and BBA Ratio for the top-tier IDIHC.

H. QUANTITATIVE IMPACT STUDY

The FRB intends to conduct a quantitative impact study ("*QIS*") of the BBA as part of its rulemaking process. The FRB's analysis of the QIS results is expected to inform its advocacy of positions in international insurance standard setting, including an aggregation method that may be deemed "outcome-equivalent" to the ICS.

SECTION 171 CALCULATIONS

In addition to the BBA, the FRB proposes to apply a separate minimum risk-based capital requirement calculation, the calculation required under Section 171 of Dodd-Frank, to IDIHCs. This separate calculation would reflect the flexibility provided by the Clarification Act by permitting IDIHCS to exclude certain state and foreign regulated insurance operations and to exempt top-tier insurance underwriting companies. The Proposal would apply the FRB's existing minimum risk-based capital requirements, subject to the election below, to a top-tier SLHC on a consolidated basis, as long as the IDIHC is not itself an insurance underwriting company. If the top-tier SLHC is an insurance underwriting company, the Section 171 requirements would apply to the farthest upstream non-insurer SLHC that is not a subsidiary of any SLHC other than the top-tier IDIHC.

Except for the option to exclude insurance operations, which is described further below, the minimum risk-based capital requirements that would apply for purposes of the Section 171 calculation are the same requirements that are applied under the generally applicable bank regulatory capital rules.[25] The proposed Section 171 calculation would be implemented by amending the definition of "covered savings and loan holding company" for the purposes of the FRB's bank regulatory capital rule. Under the Proposal, an IDIHC would become a "covered savings and loan holding company" subject to the requirements of the FRB's generally applicable minimum risk-based capital requirement unless it is a grandfathered unitary savings and loan holding company that derives 50% or more of its total consolidated assets or 50% of its total revenues on an enterprise-wide basis (as calculated under GAAP) from activities that are not financial in nature.

Under the proposed Section 171 calculation, a top-tier IDIHC subject to the generally applicable risk-based capital requirements (*i.e.*, that is not a top-tier insurance underwriting company) could elect not to consolidate the assets and liabilities of all of its subsidiary state-regulated insurers and certain foreign-regulated insurers.[26] The Proposal presents two options with regard to the regulatory capital treatment of equity investments in subsidiary insurers that are not consolidated under the election:

- Under the first option, the IDIHC could elect to not consolidate the assets and liabilities of its subsidiary state-regulated insurers, foreign subsidiaries and foreign affiliates regulated by a member of the IAIS and deduct the aggregate amount of its outstanding equity investment in such subsidiaries and affiliates, including retained earnings, from its common equity tier 1 capital elements.
- Under the second option, the IDIHC could include the amount of its investment in its risk-weighted assets and assign to the investment a 400% risk weight, consistent with the risk weight applicable under the simple risk-weight approach under the FRB's bank regulatory capital rule to an equity exposure that is not publicly traded.

An IDIHC that elects to de-consolidate the assets and liabilities of all of its subsidiary state and eligible foreign regulated insurers must indicate the manner in which it would account for its equity investment in such subsidiaries on the applicable regulatory report for the first reporting period in which it is subject to the Section 171 calculation. If the IDIHC seeks to make the election at a later time, or to change its election due to a change in control, business combination, or other legitimate business purpose, prior approval of the FRB would be required.

Section 171 also requires the FRB to establish minimum leverage capital requirements for DIHCs. The FRB's bank regulatory capital rule includes a minimum leverage ratio of 4% tier 1 capital to average total assets for all banking organizations subject to the bank regulatory capital rules, as well as a minimum supplementary leverage ratio of 3% to total leverage exposure applicable to certain large banking organizations. The Proposal, however, indicates that the FRB is not currently proposing a leverage capital requirement for IDIHCs under the BBA framework or as part of the Section 171 compliance calculation, and continues to evaluate methodologies to apply leverage capital requirements to IDIHCs.

*   *   *

ENDNOTES

1 Board of Governors of the Federal Reserve System, Notice of Proposed Rulemaking, *Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities* (Sep. 6, 2019), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190906a2.pdf.

2 Board of Governors of the Federal Reserve System, Draft Advance Notice of Proposed Rulemaking, *Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities*, 81 FR 38631 (June 14, 2016), *available at* https://www.federalregister.gov/documents/2016/06/14/2016-14004/capital-requirements-for-supervised-institutions-significantly-engaged-in-insurance-activities. For additional information on this proposal, see our memorandum to clients. "*Federal Reserve Proposes Regulatory Capital Frameworks for Supervised Insurers and Enhanced Prudential Standards for Insurers Designated as Systemically Important*" (June 7, 2016), *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Federal_Reserve_Proposes_Regulatory_Capital_Frameworks_06_07_2016.pdf.

3 Board of Governors of the Federal Reserve, *Comparing Capital Requirements in Different Regulatory Frameworks* (Sep. 5, 2019), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190906a1.pdf (the "*White Paper*").

4 Board of Governors of the Federal Reserve, *Supervision and Regulation Report* (Nov. 2018), 8, *available at* https://www.federalreserve.gov/publications/files/201811-supervision-and-regulation-report.pdf

5 The Financial Stability Oversight Council designated four non-bank financial institutions as SIFIs, three of which were Insurer SIFIs; however, in October 2018 the Council rescinded the designation of the last remaining SIFI.

6 The floor for capital requirements established pursuant to section 171, 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.

7 SAP refers to the accounting standards that apply to insurance company financial statements that are required to be filed with state insurance regulators.

8 Federal Reserve System, "*Federal Reserve Board approves advance notice of proposed rulemaking and approves proposed rule*" (June 3, 2016), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20160603a.htm.

9 The IAIS aims to be in a position at the end of the Monitoring Period to assess whether an aggregation method provides comparable outcomes (in the sense of achieving substantially the same ultimate regulatory goals) to the ICS, such that an aggregation method can be considered an "outcome-equivalent" approach for implementation of the ICS as a prescribed capital requirement.

10 The Proposal would also amend the FRB's Regulation YY by explicitly exempting IDIHCs from the FRB's stress test requirements.

11 The Proposal's definition of "financial entity" is based on the FRB's existing rules (12 CFR 252.71(r)), subject to certain modifications for purposes of the BBA.

12 As with determining whether a company meets the 25% threshold for being significantly engaged in insurance, the Proposal indicates that a supervised firm is to calculate its total consolidated assets for purposes of the MFE criteria 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 securities laws), the firm may estimate its total consolidated assets, subject to review and adjustment by the FRB.

13 The term "financial subsidiary" means any company that is controlled by one or more insured depository institutions other than a subsidiary that (A) engages solely in activities that national

ENDNOTES (CONTINUED)

banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks; or (B) a national bank is specifically authorized by the express terms of a Federal statute (other than [12 U.S.C. § 24(a)]), and not by implication or interpretation, to control, such as by section 25 or 25A of the Federal Reserve Act or the Bank Service Company Act.

[14] Company capital element is defined as "any part, item, component, balance sheet account, instrument, or other element qualifying as regulatory capital under a company's applicable capital framework prior to any adjustments and deductions under that framework."

[15] Inventory companies that are not a downstream company or a subsidiary of a top-tier IDIHC are not required to be assigned to a building block.

[16] Foreign non-insurance operations (if any) would be analyzed using the FRB's bank regulatory capital rule, and thus be subject to the scaling between federal bank regulatory capital and NAIC RBC capital positions.

[17] An intervention point in the applicable jurisdiction means the capital level at which the supervisory authority in the jurisdiction may intervene by imposing restrictions on distributions and discretionary bonus payments by the company, or the capital level at which the supervisory authority would first have the authority to take action against the company. The Proposal proposes additional jurisdictional adjustments based on a country's risk classification set by the Organization for Economic Cooperation and Development (OECD).

[18] In an apparent inconsistency, the text of the proposed Section 217.607(b)(1) makes this adjustment mandatory as opposed to optional, contrary to what the Proposal guidance indicates should be the case.

[19] The FRB derived the 300% risk weight from a review of historical title claim reserves data, observing that title claim reserves have a comparable risk profile to assets that have been assigned a 300% risk weight in the FRB's bank regulatory capital rule.

[20] According to the Proposal, "[i]f double-leverage or double-gearing exists within a building block, where the upstream (capital-providing) company and downstream (capital-receiving) company are in the same building block, the double-leverage would not be inflating capital for the building block. If double-leverage occurs with the upstream company in one building block and the downstream in a different building block, the upstream building block parent would deduct its downstreamed capital to the capital-receiving company, thereby avoiding double-counting in the calculation."

[21] The Proposal provides, in addition, that an instrument that may be called earlier than five years upon the occurrence of a rating event does not violate the qualifying capital criteria so long as the instrument was a company capital element prior to January 1, 2014 and satisfies all the other criteria for qualifying capital.

[22] A standalone prior approval requirement for any repurchase or redemption of preferred stock or subordinated debt would be consistent with the qualifying criteria for capital instruments in the bank regulatory capital rules. But a standalone prior approval requirement for any repurchase or redemption of common stock would be inconsistent with recent revisions to the FRB's bank capital regulatory capital rules. In July 2019, the FRB modified the qualifying criteria for common equity Tier 1 capital instruments to require prior approval for repurchases of common stock only to the extent otherwise required by law or regulation. The FRB explained that it made this change in light of public feedback noting "that there was a high burden associated with obtaining prior approval for all redemptions and repurchases of common stock instruments, especially with regard to standard common stock buyback programs, and that the supervisory function of requiring prior approval seemed limited where a firm was not subject to other limitations on capital actions, such as the capital conservation buffer." For additional information, see our memorandum to clients. "*Federal Reserve Eliminates Standalone Prior Approval Requirement for Common Stock Repurchases*" (July 9, 2019), *available at* https://www.sullcrom.com/files/upload/SC-Publication-Bank-Capital-Requirements-Federal-Reserve-Eliminates-Standalone-Prior-Approval-Requirement-for-Common-Stock-Repurchases.pdf.

ENDNOTES (CONTINUED)

23 Surplus notes are financial instruments issued by insurance companies that are included in surplus under SAP, and typically possess the following features: (1) the applicable state insurance regulator approves in advance the form and content of the note; (2) the instrument is subordinated to policyholder, claimant and beneficiary claims, and to all other classes of creditors other than surplus note holders; and (3) the applicable state insurance regulator is required to approve in advance any interest payments and principal repayments on the instrument.

24 If an IDIHC had no eligible retained income (for example, because its distributions equaled the change in its building block available capital, net of issuances) and its BBA ratio fell within the capital conservation buffer range, the constraints would not be graduated. Rather, unless it received approval from the FRB, the IDIHC would be unable to make any distributions for that year because it would have zero eligible retained income.

25 According to the Proposal, "[i]n its most basic form, for the [FRB]'s generally applicable minimum risk-based capital requirement, qualifying capital is the numerator of the ratio and risk-weighted assets (RWA) determine the denominator of the ratio… Under the [FRB]'s banking regulatory capital framework, the resulting ratio must be, at a minimum, 4.5 percent when considering common equity tier 1 (CET1) capital, 6 percent when considering total tier 1 capital, and 8 percent when considering total capital."

26 In accordance with Section 171, eligible foreign insurance subsidiaries are ones that are regulated by a foreign insurance regulator that is a member of the IAIS or other comparable foreign insurance regulatory authority as determined by the FRB following consultation with the state insurance regulators, including the lead state insurance commissioner of the insurance holding company system.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York		
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Roderick M. Gilman Jr.	+1-212-558-3277	gilmanr@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
Marion Leydier	+1-212-558-7925	leydierm@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com
Washington, D.C.		
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com
Hong Kong		
Garth Bray	+852-2826-8691	brayg@sullcrom.com
London		
Jeremy Kutner	+44-20-7959-8484	kutnerj@sullcrom.com
Ben Perry	+44-20-7959-8477	perryb@sullcrom.com
Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Tokyo		
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com