Meeting Between Federal Reserve Board Staff and Representatives of MetLife, Inc. (MetLife) October 9, 2014

Participants: Anna Lee Hewko, Constance Horsley, Juan Climent, Tom Sullivan, Todd Coslow, Sviatlana Phelan, Noah Cuttler, Tate Wilson (Federal Reserve Board)

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Summary: Representatives of MetLife met with Federal Reserve Board staff to discuss insurance capital standards. MetLife representatives discussed potential principles for calibrating insurance capital requirements, including: reflecting differences in funding structures across different types of financial institutions; differentiating asset capital charges by risk of loss; reflecting insurance risk in capital requirements; and including loss absorbency in insurance company reserves. The attached document was distributed by MetLife representatives during the meeting.

Attachment

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Principles for tailoring the insurance capital framework

October 9, 2014

Design principles for tailoring of the insurance capital framework

Design principles

1 Capital requirements should be calibrated to reflect differences in funding structures across different types of financial institutions

2 Capital charges for assets should be sufficiently differentiated by risk of loss

3 Capital requirements should reflect insurance risk, including an appropriate adjustment for business diversification

4 Capital should include the loss absorbency in insurance company reserves

These design principles reflect three assumptions about the Federal Reserve capital rules for non-bank SIFIs

- The Federal Reserve will regulate designated insurers on a going-concern basis
- U.S. GAAP will form the basis of the capital regulations
- The capital standards should promote sound risk management

1 Capital requirements should be calibrated to reflect differences in funding structures across different types of financial institutions

#	Implications	Rationale / commentary
A	• Recalibrate capital requirements (minimum requirements and conservation buffer) to insurance industry experience • Apply a lower SIFI buffer to insurers	• Long-term, non-callable nature of insurance liabilities allows insurers time to improve capital position • Insurers engage in significantly less maturity transformation than banks and therefore are less vulnerable to market perception
B	• Exclude from leverage ratio separate account assets where investment risks are borne primarily by the policyholder	• Insurers face no direct exposure to price changes in separate account assets where the insurer is not the beneficial owner
C	• Reduce capital requirements for closed blocks, where policyholders bear a significant portion of the credit risk	• Closed block asset losses involve significant pass-through to policyholders, mitigating the impact of such asset losses on insurer capital levels

2 Capital charges for assets should be sufficiently differentiated by risk of loss

#	Implications	Rationale / commentary
A	• Differentiate risk weights for corporate bonds based on the credit quality of the assets	• Corporate bond exposures vary markedly in credit quality • This asset class is a significant component of insurers' investments, but not of banks'
B	• Design capital requirements for variable annuities that measure the risk associated with any guarantees (reflecting hedging), not notional value of separate account assets	• Insurers only own the risk associated with the guarantee • Risk mitigation (e.g., hedging) reduces insurer exposure to capital markets-driven losses on the portfolio
C	• Reduce risk weight for policy loans to reflect that these loans pose no risk to the insurer	• Policy loans pose no risk to insurer capital (policy obligations are directly offset by the amount of policy loans outstanding)

3 Capital requirements should reflect insurance risk, including an appropriate adjustment for business diversification

#	Implications	Rationale / commentary
A	• Capture insurance risk in a more comprehensive manner (reflecting risk diversification)	• Insurers are exposed to risks that are *de minimis* or non-existent for banks, such as mortality and catastrophe risk • These insurance risks offer significantly greater diversification than market risk • A comprehensive capital framework should reflect all risks, including insurance risks
B	• Design stress testing scenarios to reflect insurer risk profile and macroeconomic sensitivity	• Insurers are exposed to different macroeconomic and other risk conditions than banks (e.g., prolonged low rates)
C	• Measure insurance risk net of reinsurance	• Insurers transfer insurance risk to third parties through reinsurance thereby reducing their exposure to losses

4 Capital should include the loss absorbency in insurance company reserves

#	Implications	Rationale / commentary
A	• Include loss absorbency capacity in insurance reserves in capital measures	• For FAS 60 contracts, the GAAP reserve exceeds the best-estimate liability value, creating loss absorbency capacity within the reserves • For FAS 97 contracts, loss absorbency capacity would be measured based on margin in cash flow testing
B	• Assign loss absorbency capacity from reserves in appropriate capital tier	• Several factors could influence the appropriate capital type

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