**Meeting Between Staff of the Federal Reserve Board and Insurance Industry Stakeholders**
**December 17, 2019**

**Participants:**  Linda Duzick, Matt Walker, Matti Peltonen, Brad Roberts, and Daniel Zaglama
 (Federal Reserve Board)

Daniel Lovrich and Jeff Williams (Allstate); Jim Brefeld, Shweta Hanji, and David Weiser (Ameriprise); Ray Natter (Barnett-Sivon); Bridget Hagan and Kelsey Wiseman (Cypress Group); Amanda Coe (MetLife); Wayne Cimons, Morgan Farrington, Margaret Nunne, and Lyle Rudin (State Farm); Megan Duffy, Bret Hester, Samuel Hodas, Jennifer Parkes, Resh Reese, and Lou Senay (TIAA); Bill Jones, Kristin Lee, Erin Martinko and Tate Wilson (USAA)

**Summary:**  Staff of the Federal Reserve Board met with insurance industry representatives to discuss the Federal Reserve Board's notice of proposed rulemaking on risk-based capital requirements for depository institution holding companies significantly engaged in insurance activities (proposal).  The attendees presented to Board staff on the proposal's calibration of the Building Block Approach capital framework.  Additionally, attendees advocated for title plant assets to be included in the proposal's calculation of available capital and for title insurance reserves to receive a lower risk-weight or be included in the calculation of available capital. Attendees also discussed the proposal's interpretation of section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Attachment

**Attachment:  Insurance Coalition Discussion Document**
**Federal Reserve Board: Building Block Approach (BBA)**

The proposed BBA capital framework is based on the risk-based capital (RBC) framework used by insurance regulators. However, the requirements are subject to significant adjustments and calibrated to bank capital requirements, resulting in a more conservative capital framework for insurers than for bank holding companies (BHCs).

**A → Minimum Requirement:**  **8.95 %** for ISLHCs compared to **8 %** for BHCs. This translates to a ~**12%** higher (bank-scaled) requirement compared to banking minimum requirement of 8% and ~**56%** higher (insurance scaled) requirement compared to the initial minimum BBA assessment of 160% of RBC.

**B → Buffer Requirement:**  **2.5%** for ISLHCs is the same as for Banking. The Board should *tailor the Capital Conservation Buffer* to the business of insurance, rather than relying upon metrics that were developed based on historical bank failures.  The capital position of banks is subject to more volatility, since banks are generally more susceptible to runs on liabilities (and consequently fire-sale risk with respect to assets).

**F → Tier 2/ Surplus Notes:** The proposal places a Tier 2/ Surplus Notes limit of **7.4%** for ISLHCs vs. **25%** for BHCs (43.75% if AT1 is included).

**G → No Additional Tier 1 (AT1)**: This restriction leads to the result that the remaining ~**93%** of the minimum requirement needs to be funded by Common Equity for ISHLCs vs. **56%** for BHCs. In addition, *all of the insurance buffer requirement* will need to be funded by Common Equity.

| Capital Elements | Insurance Requirement | | Bank Capital Requirement | Example of Impact ($MM)[1] | Supporting References |
|---|---|---|---|---|---|
| | *BBA* | *Calibration* | | | |
| Initial Min. Assessment | 160% | 8%[2] | | | Ref (6) |
| (A) Minimum Requirement | 250% | 8.95% | 8% | $333 | Ref (9) |
| (B) Buffer Requirement | 235% | 2.5% | 2.5% | | |
| (C) Total Requirement | 485% | 11.4% | 10.5% | | Ref (12) |
| **Qualifying Capital Limits** | | | | | |
| (D) Tier 2 Limit/ Risk Weighted Assets (RWA) | 0.66%[3] | | 2.0% | | Ref (17) |
| (E) Additional Tier 1 (AT1) Limit/ RWA | | | 1.5% | | |
| (F) Tier 2 (D) / Min. Req (A) | 7.4% | | 25.0% | $468 | |

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[1] Assumes a hypothetical company with Tier 1 Capital = $7.5B, Tier 2/Surplus Notes Capital $1B, Risk-Weighted Assets $35B

[2] $BBA = \dfrac{T1+T2-0.063*RWA}{0.0106*RWA}$

[3] $T2_{Maximum} = 0.625 * 0.0106\ RWA$

| | | | |
|---|---|---|---|
| (G) AT1 (E) / Min. Req (A) | | 18.75% | $525 | |

## Explanatory Background

### Definitions
T1 = Tier 1 Capital
T2 = Tier 2 Capital
RWA = Risk Weighted Assets
$[T1+T2]_{Minimum}$ = Minimum Capital to Attain 250% BBA Ratio
$[T1+T2]_{Target}$ = Minimum Capital to Achieve 485% BBA Ratio
$T2_{Max}$ = Maximum Allowable Tier 2 Capital

### BBA Scaling
Available$^*$ = Scaled Available Capital = T1 + T2 − 0.063 RWA
Req$^*$ = Scaled Required Capital = 0.0106 RWA

$$BBA = \frac{Available^*}{Req^*}$$

### Representation of BBA on Unscaled basis

(1) $BBA = \frac{T1+T2-0.063*RWA}{0.0106*RWA}$   By Definition of Available*, Req*

(2) $BBA = \frac{T1+T2}{0.0106*RWA} - \frac{0.063*RWA}{0.0106*RWA}$   Rearranging (1)

(3) $BBA = 94.34 * \left[\frac{T1+T2}{RWA}\right] - 5.94$   Rearranging (2)

### Minimum BBA Target of 160% implies

(4) $1.60 = 94.34 * \left[\frac{T1+T2}{RWA}\right] - 5.94$   From (3)

(5) $7.54 = 94.34 * \left[\frac{T1+T2}{RWA}\right]$   Rearranging (4)

(6) $8\% = \left[\frac{T1+T2}{RWA}\right]$   Rearranging (5)

### Minimum BBA Target of 250% implies

(7) $2.50 = 94.34 * \left[\frac{T1+T2}{RWA}\right] - 5.94$   From (3)

(8) $8.44 = 94.34 * \left[\frac{T1+T2}{RWA}\right]$   Rearranging (7)

(9) $8.95\% = \left[\frac{T1+T2}{RWA}\right]$   Rearranging (8)

### Minimum BBA Target of 485% implies

(10) $4.85 = 94.34 * \left[\frac{T1+T2}{RWA}\right] - 5.94$   From (3)

(11) $10.79 = 94.34 * \left[\frac{T1+T2}{RWA}\right]$     Rearranging (10)

(12) $11.44\% = \left[\frac{T1+T2}{RWA}\right]$     Rearranging (11)

## BBA Capital Buffer

By (9), minimum BBA ratio of 250% implies minimal capital of

(13) $[T1 + T2]_{Minimum} = 8.95\%\ RWA$

By (12), BBA with conservation buffer ratio of 485% implies capital with buffer of

(14) $[T1 + T2]_{Target} = 11.44\%\ RWA$

By (13) & (14), capital conservation buffer is

(15) $[T1 + T2]_{Target} - [T1 + T2]_{Minimum} = 11.44\%\ RWA - 8.95\%\ RWA = 2.50\%\ RWA$

## Implications of 62.5% Tier 2 Cap

Suppose $T2_{Max} = Req^{*}$

Then, by definition of BBA Scaled Requirement,

(16) $T2_{Maximum} = 0.625 * 0.0106\ RWA$

Expressed alternatively,

(17) $0.66\% = \left[\frac{T2_{Max}}{RWA}\right]$     Rearranging (16)