ACLI
Financial Security...for Life.

Public Policy Issue Brief

FEDERAL CAPITAL STANDARDS

BACKGROUND

Through authorities provided in the Dodd-Frank Act, the Federal Reserve Board (Fed) regulates at the holding company level a number of companies that are primarily life insurers. The Dodd-Frank Act granted the Federal Reserve Board new supervisory authority over Savings & Loan Holding Companies (SLHCs), many of which are, or own, life insurers. The Dodd-Frank Act also authorized the Fed to supervise nonbank financial companies, which may include insurance companies, that are designated systemically important by the Financial Stability Oversight Council.

In July 2013 the Federal Reserve Board issued a final rule implementing new capital standards for financial services companies. Known as Basel III, these new standards are bank-based capital rules that favor short-term assets and include only a temporary exemption for insurers that are or are owned by SLHCs. However, as a result of section 171 of the Dodd-Frank Act (the Collins Amendment), it remains unclear how or if the Fed will apply Basel III to those insurers, or to insurers that are designated systemically important.

Life insurers are greatly concerned that the Fed may ultimately apply bank-centric standards and methodologies to insurance companies. Life insurance companies have a need for long-term assets that match long-term, guaranteed life insurance and annuity products. Insurance risk-based capital (RBC) requirements are therefore the appropriate standards to apply to an insurance company.

STATUS

On April 29, 2014, Congress re-introduced legislation (S. 2270 and H.R. 4510) to allow the Federal Reserve Board the flexibility to apply insurance-based capital standards to insurance companies. This would prevent bank capital rules from being inappropriately imposed on insurers.

S. 2270 is sponsored by Senators Susan Collins (R-Maine), Sherrod Brown (D-Ohio), and Mike Johanns (R-Neb.). H.R. 4510 is sponsored by Representatives Gary Miller (R-Calif.) and Carolyn McCarthy (D-N.Y.)

On December 10, the House passed S. 2270 by unanimous consent. S. 2270 previously passed the Senate on June 6 also by unanimous consent. The President signed the bill into law on December 18, 2014.

ACLI POSITION

ACLI strongly supports S. 2270 and applauds Congress for sending the Insurance Capital Standards Clarification Act of 2014 to the President's desk for quick enactment in 2014. Misapplication of bank-based standards to insurance companies would disrupt the insurance business model and the industry's ability to provide long-term, guaranteed retirement products and financial protection to customers.

AT A GLANCE

- Insurance-specific risk-based capital standards are the right standards for life insurers that offer retirement and financial security products with long-term guarantees that protect 75 million American families.
- Capital standards appropriate for banks are not appropriate for life insurers. The risk profiles, balance sheet characteristics, and business models of banks and insurance companies are vastly different.
- If life insurers are required to hold excessive amounts of short-term assets by bank-based capital rules, the availability and affordability of financial security products could be affected.
- The Federal Reserve rulemaking is the first attempt by the federal government to set capital standards to the state-regulated insurance industry.
- State insurance regulators already enforce strict capital standards at the state level to protect consumers and ensure claims are paid quickly and efficiently.
- Life insurers pay out $1.5 billion to families and businesses every day.
- Our products are needed now more than ever—every day for the next 15 years, some 10,000 baby boomers will reach age 65 and need a source of long-term income to supplement Social Security.

POLICY–MAKER CONSIDERATIONS

The Dodd-Frank Act Authorizes the Fed To Apply Robust Insurance Capital Standards. Insurance risk-based capital standards are a proven, reliable, and comprehensive measure of an insurance company's financial strength. Insurance RBC standards, which have been developed over many decades by state insurance supervisors, provide the best measure of the capital needs of an insurer and are the best tool for the Fed to assess an institution's capital adequacy. Only insurance RBC standards are specifically designed to analyze the long-term asset/liability matching posture of life insurers. Substituting bank-centric standards for insurance RBC standards undermines rather than enhances supervision of insurance companies.

Insurers Must Hold Long-Term Assets To Match the Long-Term Guarantees in Insurance Products. While banks have a need for short-term, liquid assets to match demand deposit banking products, life insurance companies have a need for long-term assets that match long-term, guaranteed life insurance and annuity products. Bank-centric Basel III capital rules that favor short-term assets and assign higher risk-weights to long-term assets simply do not work for the insurance company business model, in which commitments to insurance policyholders and annuity investors may last many decades. Applying bank-centric capital standards to insurance companies would disrupt the insurance business model and the industry's ability to provide long-term, guaranteed retirement products.

Misapplication of Bank-Centric Standards To Insurers Would Create Regulatory Confusion. Layering bank-centric capital and accounting standards at the federal level onto existing insurance standards enforced at the state level would create regulatory confusion. Because bank-centric standards favor short-term, liquid assets while state insurance standards emphasize long-term assets and asset/liability matching, insurance companies may be pulled in different directions by regulators. Insurance companies would face difficulties trying to be in compliance with two competing sets of standards.

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LAST REVIEW DATE: DECEMBER 2014

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