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Federal Banking Regulators Temporarily Exempt Selected Insurance Operations from Final Capital Rule

July 15, 2013

July 15, 2013 -- The Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively "Agencies") have adopted a final rule ("the Rule") modifying the Agencies' general risk-based capital rules, advanced approaches rule, the market risk rule and leverage rules and significantly increasing the capital requirements for national banks, state member banks, federal savings associations and certain bank and savings and loan holding companies. The Rule, in part, reflects agreements reached by the Basel Committee on Banking Supervision (commonly referred to as Basel III), including subsequent changes to the Basel III's capital standards and recent consultative papers. The Rule also includes changes consistent with the requirements of the Dodd-Frank Act and reflects significant changes from the proposed rule, in part due to extensive public comments received on the proposed rule. The Rule is highly technical, both in its terms and in its application to specific factual situations and organizations, with many exceptions and qualifications. The capital provisions contain complicated definitions and provisions concerning two tiers of capital, regulatory adjustments and deductions, minimum regulatory capital ratios, additional capital requirements, overall capital adequacy and investments in hedge funds and private equity funds. The provisions relating to risk-weighted assets provide for extensive evaluation of credit risks, off-balance sheet items, over-the-counter derivative contracts, cleared transactions, credit risk mitigation, unsettled transactions and securitization exposures. The Rule also contains provisions concerning equity exposures, insurance-related activities, market discipline and disclosures. Under the proposed rule, stringent capital and other financial standards would have applied to some insurance companies or insurance operations, potentially leading to financial hardship and conflicts with the financial regulation of insurance companies by state insurance departments. Concern in the insurance industry that the proposed rule might apply to insurers that own a savings and loan is one of a number of reasons why some insurance companies have been selling their savings and loans or insured deposits business. Recognizing that bank-centric rules

might not be appropriate for insurance operations, the Agencies have, at least temporarily, excluded the following entities from the Rule, pending further consideration of such organizations by the Agencies.

1. savings and loan holding companies that are substantially engaged in insurance underwriting activities;

2. savings and loan holding companies that are insurance underwriting companies; and

3. savings and loan holding companies which hold 25% or more of their total consolidated assets in insurance underwriting subsidiaries. The calculation of total consolidated assets for this purpose must be determined in accordance with GAAP.

The Rule defines "insurance underwriting company" to mean "an insurance company, as defined in section 201 of the Dodd-Frank Act (12 U.S.C. 5381), that engages in insurance underwriting activities. This definition includes companies engaged in insurance underwriting activities that are subject to regulation by a State insurance regulator and covered by a State insurance company insolvency law." The Rule has been enacted in the context of the Dodd-Frank Act, which generally reaffirms the primacy of the state regulation of insurance and the jurisdiction of state insurance regulators in the liquidation of insurance companies. Nevertheless, under the terms of the Rule, the exemptions for insurance companies and insurance activities that are listed above are explicitly temporary, and subject to further study and revision by the Agencies. In addition, the recent designation of three insurance companies by the Federal Stability Oversight Council ("FSOC") as systemically important, and hence subject to enhanced prudential regulation by the Federal Reserve, demonstrates that there is no bright line dividing the banking and insurance industries in this regard. Indeed, reports of the methodology used by FSOC in arriving at the determination to make those designations is said to confirm that at least some federal regulators continue to apply bank-centric methodologies and principles to insurance companies and insurance operations. This Rule is an important step in the evolution of the federal regulation of the financial services sector, but it is by no means the final step. Insurance companies need to continue to monitor the development of regulation by the Agencies and FSOC.

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Life, Annuity, and Retirement Litigation

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