SHELTER INSURANCE COMPANIES

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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

RE: Notice of Intent to Require Reporting Forms for Savings and Loan Holding Companies

Dear Secretary Johnson:

Shelter Mutual Insurance Company ("Shelter") is writing to comment on the above-referenced notice (the "Notice") issued by the Federal Reserve Board (the "FRB") February 8, 2011.

Shelter is a mutual property and casualty insurance company organized and licensed as a domestic insurer under the laws of the State of Missouri. Shelter is licensed to do business as an insurance underwriter in 14 states. Shelter has no publicly traded equity, and has net admitted assets on a statutory accounting basis of \$2.3 billion as of December 31, 2010. In April of 1999 Shelter formed a federal savings bank subsidiary, Shelter Financial Bank (the "Bank"). The Bank was organized as a wholly owned subsidiary of Shelter Financial Corporation, which is a wholly owned subsidiary of Shelter, making Shelter a savings and loan holding company ("SLHC") under the Home Owners Loan Act.

Impact of Notice:
Potential Burden on Nonpublic Insurance Underwriter SLHCs to Create Duplicative Financial Statements

The Notice proposes to require each SLHC to file with the FRB the same reports as a bank holding company (a "BHC") is required to file, beginning with the March 31, 2012 reporting period. These filings would be made in lieu of the current OTS-required reports. The FRB reports include forms such as the FR Y-9C, which require filing companies to prepare standardized financial statements in accordance with Generally Accepted Accounting Principles ("GAAP"). *See* FR Y-9C General Instructions, at GEN-3. The Notice has been issued pursuant to the transfer to the FRB of OTS supervisory functions over SLHCs effected by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd Frank Act").

As an SLHC, Shelter currently files financial reporting forms as designated by the Office of Thrift Supervision (the "OTS"). However, as a privately held, licensed mutual insurance organization, Shelter is required by law to prepare its financial statements in accordance with Statutory Accounting Principles ("SAP"), rather than GAAP. Shelter has never been required by the OTS or any state insurance regulatory agency to incur the excess cost of preparing duplicative financial statements in accordance with GAAP to supplement Shelter's legally required SAP financial statements. However, the Notice indicates an intention on the part of the FRB to require Shelter as an SLHC to prepare additional financial statements on both a separate entity GAAP basis and a consolidated GAAP basis, which would be duplicative of the legally required financial statements prepared in accordance with SAP as mandated by the proper state insurance regulatory authorities.

As requested in the Notice, Shelter hereby provides comment on: "a. whether the planned collection of information is necessary for the proper performance of the [FRB]'s functions ... b. The burden of the planned information collection proposal; ... and d. ways to minimize the burden of information collection on respondents ..."

Shelter Insurance Organization and Background

Shelter was formed as a mutual insurer in Missouri in 1946 and is now licensed in 14 states to write insurance. Shelter predominately writes property risks, such as auto insurance and homeowners insurance.

As stated above, Shelter has net admitted assets on a statutory accounting basis of $2.3 billion as of December 31, 2010. Shelter owns either directly or indirectly several other non-banking entities, including:

- Shelter General Insurance Company, a property and casualty insurer (Assets of $184 million)
- Shelter Life Insurance Company, which issues traditional life and annuity products (Assets of $961 million)
- Shelter Reinsurance Company, a global reinsurer, concentrating on property risks (Assets of $286 million)
- Haulers Insurance Company, a property and casualty insurer (Assets of $59 million)
- Shelter Benefits Management Inc., a benefits management company for its affiliates (Assets of $252 million)

Shelter established the Bank in 1999 because it desired a banking entity within the Shelter organization to supplement the organization's insurance operations through synergistic marketing strategies. Customers who need insurance often need financing alternatives including consumer and mortgage loans. Through its one location in

Columbia, Missouri, the Bank provides commercial loans, home equity loans, first mortgages, and secured personal loans and accepts time deposits and money market deposit accounts from customers located primarily in the Midwest. The Bank's investments are invested solely in certificates of deposit. As of December 31, 2010, the Bank had $181 million in total assets, which is less than 5 percent of the total assets of the consolidated Shelter Insurance organization (over $3,638,000,000).

Statutory Accounting Principles Requirement for Insurance Underwriter SLHCs

As a condition to accreditation by the National Association of Insurance Commissioners ("NAIC"), all states, including Missouri, have incorporated legislation or regulations requiring the application of SAP for the reporting of insurer financial statements. SAP accounting is generally considered to be significantly more conservative than GAAP, as evidenced by the following examples:

- SAP measures the "health" of the insurance company through conservative invested asset values and strong insurance reserves.
- SAP focuses on the balance sheet, ensuring policyholders that the company has the ability to pay claims. For example, certain assets are eliminated from the balance sheet under SAP, such as furniture and equipment, intangible assets, deferred and prepaid items. These assets are unavailable to pay claims and hence are "non-admissible," which reduces total assets and capital.
- SAP is also conservative in terms of charging all expenses against income as of the date they are incurred. Such accounting results in lower net income and hence less capital on a SAP basis.

The FRB has reviewed distinctions between SAP and GAAP and has recognized the conservative nature of SAP: "Insurance Company statutory financial reports are based on [SAP], which are designed to address the concerns of regulators ... Conservatism serves as a major principle in SAP." Report of the [NAIC] and the Federal Reserve System Joint Troubled Company Subgroup: A Comparison of the Insurance and Banking Regulatory Frameworks for Identifying and Supervising Companies in Weakened Financial Condition, page 10 (April 19, 2005).

All of the conservative adjustments listed above would serve to demonstrate solvency of an insurer to its regulators and policyholders and form a more conservative basis for the FRB to evaluate an insurance company.

By using SAP-based financial statements, state insurance regulatory agencies assess solvency of insurance underwriters through a risk-based capital formula specific to insurers, which provides for a thorough analysis of the safeness and soundness of the operations. In addition, insurers are subject to a risk-focused examination by their regulatory "home state," which is driven by the SAP-based financial reports. The examination not only focuses on the accuracy and application of SAP, but on the identification of risk inherent in an insurer's operations. The information gathered from the SAP-based financial statements is utilized in formulating the ongoing regulatory supervision of an insurer and would provide the necessary information for the proper performance of the FRB's regulatory functions.

Federal Bank Regulatory Treatment of SAP vs. GAAP Issue

Because the Notice is based upon the Dodd Frank Act requirements for transfer of OTS regulatory authority to the FRB, Shelter encourages the FRB to adhere to the legislative directives behind the Dodd Frank Act as evidenced by the Senate Report,[1] which clearly envisions that the regulatory authorities would allow insurance underwriter SLHCs to retain their current accounting methods:

> It is the intent of the Committee that such companies will be permitted to provide financial reporting to the [appropriate federal banking agency, i.e., the FRB] utilizing the accounting method they currently employ in reporting their financial information. **More specifically, nothing in this provision [Section 616 of the legislation] is intended to mandate that insurance companies otherwise subject to alternative regulatory accounting practices and procedures use GAAP reporting**. [*emphasis added*] Senate Report No. 111-176, at 89 (April 30, 2010), issued by the Senate Committee on Banking, Housing and Urban Affairs.

As stated above, the OTS has historically followed the policy endorsed by this Senate Report by allowing insurance underwriter holding companies to file SAP-based financial statements: "Holding companies that are insurance companies may file financial statements prepared in conformity with statutory accounting principles only if they do not prepare GAAP financial statements for any other purpose." OTS Thrift Bulletin 86, H-(b)11 Annual/Current Report, Index of Items, Item 5. Financial Statements (September 2, 2010); *see also* OTS Holding Company Handbook, Section 930.

The FRB follows an analogous policy currently by allowing foreign banking organizations to file financial statements in accordance with the local accounting practices of the home country of the foreign banking organization. *See* FRB General Instructions for Preparation of the Annual Report of Foreign Banking Organizations (FR Y-7), Report Item 1(a) (December 2006). Similarly, the FRB exempts functionally regulated subsidiaries, including insurance underwriters, from filing the FR Y-11, which is a GAAP-based form. *See* Instructions for Preparation of Financial Statements of U.S. Nonbank Subsidiaries of U.S. Bank Holding Companies (FR Y-11 and Y-11S) at GEN-2, GEN 3 (March 2011). Surely, if the FRB can adequately analyze and supervise foreign bank organizations using a variety of non-GAAP reporting methodologies, then the same could be true of SAP accounting.

[1] Because the Dodd Frank Act was passed after a conference committee procedure, the Senate Report was issued regarding S.B 3217, 111th Cong. (2010), which was later incorporated into the Dodd Frank Act.

Burden of Creating Additional GAAP Financial Statements

Conversion from a SAP-only accounting basis to a system that would accommodate both SAP and GAAP financial statements would create a substantial burden on Shelter and its insurance subsidiaries for reporting financial statements to the FRB. Shelter would be required to expend significant costs and time to convert all of the SAP-based financials of itself and its numerous insurance subsidiaries. Such a conversion effort would include significant costs for increased accounting staff, actuarial expertise, and tax accounting consultants, which would be to the detriment of the organization's mutual policyholders. Such a conversion would consume the very capital that bank regulators seek to preserve, and in the specific case of Shelter, would likely eliminate most, if not all, of the Bank's annual net earnings.

As noted above, Shelter is a large insurer with several other insurance subsidiaries. Shelter's predominant business is state regulated insurance. Its ownership of a small thrift subsidiary with 2010 net income of $868,000 (less than 1% of the income of Shelter alone) should not dictate the type of accounting operations of the predominant business entities in the global Shelter organization.

The Notice states that the Board acknowledges there would be initial increased burden on SLHCs, but believes there would be long-term efficiencies. While this statement may be true for SLHCs engaging in a simple change from filing GAAP-based OTS forms to filing GAAP-based FRB forms, it is not accurate with regard to privately held insurance underwriter holding companies that will be forced to incur the costs of implementing an entirely new and duplicative accounting system (GAAP), while retaining their existing and legally required accounting system (SAP). Shelter can state unqualifiedly that it will gain no efficiencies from the additional required statements nor will the costs remain short-term. Shelter would derive no benefit from required GAAP reporting.

In fact, any consideration by the FRB of requiring GAAP reporting for entities such as Shelter, should include consideration of the timing necessary for such a change. The imposition of such a substantial addition of regulatory reporting requirements would take many months for an entity such as Shelter to implement. Shelter could not be in a position to accurately reflect financial reporting in a GAAP format until late 2013, and the costs of maintaining the two systems of accounting (SAP and GAAP) would continue thereafter.

In its regulatory comment on the recent Joint Notice of Proposed Rulemaking for Establishment of a Risk-based Capital Floor, the Financial Services Roundtable, a national trade organization summed up the SAP vs. GAAP issue:

> Another particular insurance industry issue that has come to our attention arises from the fact that many insurance companies do not report their financial condition using [GAAP], but rather use [SAP]. It would create a substantial burden on any such company to be required to use GAAP,

> instead of SAP, to calculate its capital requirements as such an insurance company would then need to use two different accounting systems and possibly double its accounting costs. Letter from Richard M. Whiting, Executive Director of the Financial Services Roundtable, page 6, Feb. 28, 2011.

Similarly, in 2004, in connection with a rule on assessments, the OTS addressed the burden that would be placed upon insurance underwriter SLHCs filing only SAP financial statements if those companies were also required to file GAAP financial statements:

> SLHCs that underwrite insurance must file financial statements with state insurance departments using SAP. While many of these insurance underwriters are publicly traded and must also prepare and file GAAP statements with the SEC, mutual or closely held insurance underwriters typically prepare only SAP statements. ... OTS believes that the costs of preparing a separate set of GAAP financial statements solely for the purposes of the assessments rule would impose unnecessary expenses on these SLHCs and would be contrary to OTS's ongoing regulatory burden reduction efforts. Assessments and Fees, 69 Fed. Reg. 30554 at 30561-30562 (May 28, 2004).

Conclusion

Shelter urges the FRB to allow nonpublic insurance underwriter holding companies to file their financial statements with the FRB in accordance with SAP, without requiring such holding companies to file additional, duplicative GAAP statements. This approach would be consistent with the directives of the Senate Report issued in connection with the Dodd Frank Act, the FRB's policy regarding financial statement filings by foreign banking organizations and the well-reasoned precedent of the OTS allowing nonpublic insurance underwriter SLHCs to file SAP-based financial statements unless such companies are otherwise required to file GAAP-based statements. It would also serve to preserve small, community-serving financial institutions which companies like Shelter have created, which have historically proven to be strong and financially sound.

In response to the comment issues set forth in the Notice, Shelter believes use of the legally required SAP financial statements of nonpublic insurance underwriter holding companies such as Shelter will (a) provide the FRB with adequate collection of information necessary for the proper performance of the FRB's functions in the regulation of such holding companies; and (b) minimize the excessive burden of requiring duplicative GAAP financial statements from such companies.

In the event the FRB determines it cannot accept SAP financial statements as addressed above, Shelter requests consideration of a delay in the timing of GAAP reporting enforcement to allow for adequate preparation and conversion and to minimize the burden of information collection.

If you have any questions regarding this correspondence, please contact the undersigned.

Sincerely

Christina Workman