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

Subject: Docket No. R-1425 and RIN No. 7100 AD 77
Proposed Rule Amending Regulation Y—Capital Plans

Dear Secretary Johnson:

On behalf of Nationwide Mutual Insurance Company and its affiliated companies (Nationwide), we appreciate the opportunity to comment on the above-referenced proposal. Nationwide operates through an insurance holding company system registered with the Ohio Department of Insurance. By virtue of its ownership of Nationwide Bank, member FDIC, Nationwide is registered as a savings and loan holding company (SLHC) pursuant to Section 10 of the *Home Owners' Loan Act of 1933* (HOLA) and, therefore, is impacted by the proposed rule. [1]

In connection with our more detailed comments below, we respectfully request that the Board consider refining the rule to more carefully tailor its scope to actual risk and risk profile. Specifically, we believe that the Board should:

- (1) Narrow the application of the proposed rule using one or more objective tests so that it applies not to all large SLHCs, but only to SLHCs that own large banks;
- (2) Look to state insurance law for capital requirements and dividend restrictions when applying the rule to an operating mutual insurance company that is also a SLHC;

[1] While the proposed rule, if adopted, would apply to U.S. bank holding companies with total consolidated assets of $50 billion or more and not to large SLHCs, the Board states in footnote 9 of the proposal that through separate rulemaking or by order, it is expected that the proposal's requirements would be extended to large SLHCs and nonbank financial firms supervised by the Board pursuant to Section 113 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Act). Nationwide hereby submits this comment letter because of the implications of the possible extension of the rule to large SLHCs.

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- (3) Include a transition period for institutions that did not participate in the Comprehensive Capital Analysis and Review (CCAR);
- (4) Create an exemption from the prior-notice requirement if the effect of the capital distribution would be *de minimis*, even if the distribution exceeds a prior filed and approved capital plan.

Specific Comments

1.) The Board Should Exclude from the Proposed Capital Planning Requirements SLHCs that Own Smaller Depository Institutions.

The capital planning requirements in the proposed rule explicitly and appropriately apply to bank holding companies (BHCs), but in Nationwide's view, should not apply to all SLHCs. Under long-standing Federal Reserve supervisory practice, a BHC is expected to serve as a source of strength to subsidiary banks.[2] Moreover, the Dodd Frank Act specifically extended the source-of-strength doctrine to encompass not just BHCs, but also SLHCs.[3] However, linking the capitalplanning requirement to all SLHCs could actually undermine the statutory purpose and design that a SLHC serve as a source of strength since the requirement could impose an undue costly burden on SLHCs. We believe that it is unnecessary and overbroad to apply the capital planning requirement to all SLHCs, and that the requirement should reflect the actual risk of the SLHC's failure to serve as a source of capital strength to its subsidiary bank. In other words, SLHCs with smaller subsidiary depository institutions should be excluded from a formal capital plan requirement.

We believe that given the statutory applicability of the source-of-strength doctrine to SLHCs, the BHC supervisory framework does not materially enhance capital adequacy and the ability to operate when applied to a SLHC with a smaller depository institution. In such a case, the SLHC may have more than enough resources to ensure sufficient capital for the depository institution and may not rely in any way upon dividends from the subsidiary depository institution. When applied to such SLHCs, the proposed capital plan requirement would pose unnecessary expense and burden in derogation of source of strength. We think that it would be inappropriate to subject a SLHC that is not systemically significant, or one which demonstrates a lower degree of depository

[2] "A fundamental principle underlying the Federal Reserve's supervision and regulation of BHCs is that a BHC should serve as a source of managerial and financial strength to its subsidiary banks. Consistent with this premise, the Federal Reserve expects an organization to hold capital commensurate with its overall risk profile." Division of Banking Supervision and Regulation SR Letter 09-4 (Feb. 24, 2009)(revised March 27, 2009), at p. 2.
[3] Section 616(d) of the Act (adding Section 38A to the *Federal Deposit Insurance Act*).

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activities within its structure under objective tests, to a formal capital requirement. Furthermore, if such a SLHC is predominately engaged in the business of insurance, we believe that the SLHC would likely have more than adequate capital on hand with which to serve as a source of strength for its smaller bank.

We suggest that the Board consider applying an objective test to determine whether a SLHC should be subject to the formal capital plan requirement because it owns one or more large banks. Nationwide provides a good example of the inappropriateness of the application of the capital plan requirement to certain SLHCs. Nationwide Bank is a federal savings bank with $4 billion in total assets. Nationwide has invested $350 million in equity constituting the Bank's capital and Nationwide as an operating insurance company maintains over $17 billion in statutory surplus. We believe that the BHC supervisory framework is more effectively directed toward BHCs or SLHCs other than SLHCs of smaller banks. The Board's creation of an exclusion for SLHCs with small banks would further the statutory purpose of enhancing their ability to act as a source of strength while avoiding the imposition of an inappropriate burden. Nationwide believes that if the regulation is focused on holding companies of large banks rather than all large holding companies, the cost of compliance and risk management systems is more likely to be commensurate with the risk. With respect to holding companies that own small banks, the cost of compliance should be rationally related to the consolidated assets of all the depository institutions under the control of the holding company.

Specifically, Nationwide believes that in the case of an SLHC that is a top tier mutual insurance company owning a small bank, there are much less expensive means to ensure source of strength that do not create an undue burden. The Federal Reserve, as a SLHC regulator, has other supervisory tools already available that could be more precisely tailored to the actual risk without adding unnecessary burdens and costs. Such tools should be deployed consistently across the country with uniform guidance from the Board of Governors to all Federal Reserve Banks. For example, a capital planning requirement should be applied to SLHCs; however, we believe that a formal annual capital planning requirement subject to regulatory approval and limits, as embodied in the proposed rule, is neither appropriate nor necessary.

We suggest that the Board consider applying an objective test to determine whether an SLHC should be subject to the formal capital plan requirement because it owns one or more large banks. Nationwide believes that any one of several tests would be appropriate. First, the Board could rely upon a designation under Title I of the Act by the Financial Stability Oversight Council that a firm is systemically significant and subject to the Board's supervision under heightened prudential standards. Thus, only bank holding companies with $50 billion in assets and nonbank financial firms that are designated as nonbank systemically important financial institutions (SIFIs) would be subject to heightened prudential standards, one of which could include the filing of the proposed formal annual capital plan. We note that although the $50 billion threshold for bank holding company designation is tied to the holding company and not to the size of the bank, nonetheless virtually all bank holding companies falling into the statutory threshold maintain large banks. We also believe that an insurance company with a small bank should be less likely to be deemed significant given the less risky business model of insurance relative to banking. We think that for SLHCs, a Council designation is an efficient and appropriate way for the Board to determine that an SLHC should be subject to the proposed regulation.

A second, alternative, objective test the Board could use with respect to SLHCs is one based upon the definition of "predominately engaged" as set forth in Section 102(a)(6) of the Act concerning financial activities. If the SLHC's activities are predominately depository, then the capital planning regulation should apply. Under this test, a SLHC with $50 billion or more in assets that owns one or more large banks on a consolidated basis would be covered by and subject to the formal capital plan requirement. Such a SLHC would be defined as one in which the annual gross revenues derived by all of its depository institution subsidiaries represents 85% or more of the consolidated annual gross revenues of the company. Alternatively, this test could define a covered SLHC as a SLHC in which the consolidated assets of all its depository institution subsidiaries represent 85% or more of the consolidated assets of the company. As in the context of financial activities, the 85% tests capture the degree and substance of the activities of the holding company.

A third alternative test the Board could use for SLHCs with $50 billion or more in assets in determining whether the formal capital planning requirement should apply is the ratio of depository institution capital to holding company capital. Thus, a multiple of x (defined by the Board) could result in the imposition of a capital planning requirement, but one that is more flexible, less costly, and less burdensome to the holding company than the automatic imposition of a formal capital planning requirement as proposed.

We believe that such objective tests would provide an effective method of sweeping in only appropriate SLHCs, and should be established by the Board of Governors and deployed consistently across the country. In sum, in the instances where an SLHC owns large banks or is determined to be systemically significant by the Financial Stability Oversight Council in light of the eleven statutory factors, the value of a capital plan is apparent. By contrast, if a large SLHC owns a small bank and does not raise source-of strength-concerns given its capital resources relative to its small depository institution, then the value of a capital plan is much less obvious and could actually pose unnecessary expense and burden, undermining the role of the SLHC as a source of strength.

2.) <u>The Board Should Rely on State Insurance Regulators and State Law Regarding Capital Planning for an Operating Insurance Company.</u>

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As Nationwide noted in prior comment letters, the business of insurance is materially different from the business of banking. We recommend that the Board recognize this difference in its regulation of SLHCs that are operating insurance companies. The risks, time horizons and frameworks of the two business models are fundamentally distinct. For example, catastrophe risk of an insurer does not compare to that of a bank. Likewise, credit risk or interest rate risk for a bank does not compare to that of an insurer. Because these differences between insurance and banking are so large, the information derived from an insurance company through a formal capital plan filing may be of limited value and lack data comparability across holding companies filing annual capital plans.

The regulatory regime governing capital requirements for insurance companies is also very different than for banks. For example, as a mutual insurance company, Nationwide is already subject to conservative risk-based capital requirements under state insurance law. These capital standards support the financial strength of its downstream subsidiary depository institution. Moreover, an insurer's failure to meet minimum ratios can trigger state insurance regulatory actions including authorizing or requiring the state insurance department to assume conservatorship or receivership of the insurer. The process is somewhat similar to the prompt corrective action regime for insured depository institutions under the *Federal Deposit Insurance Act*.

And finally, mutual insurance companies are authorized to pay dividends to the policyholders who own the company. Under state insurance law, payments to policyholders are not capital distributions in the sense of dividends on equity or debt instruments. Thus, a capital action issued by the Federal Reserve under the proposal directed to a SLHC that is also a mutual insurance company could pose serious state insurance law issues.

Unlike equity or debt, insurance policies issued by mutual insurance companies are indemnity contracts priced according to a number of risk assumptions determined by actuaries. One assumption upon which pricing or other policy features may be based includes the possibility of a policy dividend. For example, workers compensation policies can authorize the payment of dividends. While the payment of dividends is not guaranteed by the policy, a board of directors of the mutual company declaring a dividend will often calculate a dividend based upon standards filed with the state insurance department. The standards can be based upon policy loss ratios and experience. Nationwide's concern is that a capital action by the Federal Reserve against a SLHC that is an operating mutual insurance company could frustrate policyholder expectations rooted in state insurance law concerning the payment of dividends under a policy that is priced based upon actuarial assumptions pursuant to a plan and reflected in a form filed with the State insurance department. This concern would extend to other lines of mutual insurance, where, under state insurance law, a policyholder is a member of the company whose policy reflects a membership interest and policy rights.

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Finally, a Federal Reserve capital action could prejudice the rights of policyholders under state insurance laws that provide for state regulatory suspension of or limitation on dividends in the event that the insurer's financial condition is found to be hazardous to the public. Excluding from the proposed rule operating mutual insurance companies that are SLHCswould eliminate this problem.

3.) <u>The Proposed Rule Should Include a Transitional Period for Institutions That Did Not Participate in the Comprehensive Capital Analysis and Review (CCAR).</u>

In our view, the final rule should include a transitional period, consistent with Section 171(b)(4)(D) of the Dodd-Frank Act, for institutions that did not participate in CCAR. Section 171(b)(4)(D) allows for a transition period through July 21, 2015 with respect to depository institution holding companies not supervised by the Board on May 19, 2010. For example, Nationwide's primary federal supervisor on that date was the Office of Thrift Supervision and therefore, in our view, the capital requirements of the Act, including a formal capital plan filing requirement, should also be subject to a five-year transition period. The purpose of transition periods is to avoid disruption and to facilitate an orderly phase in of requirements, and allowing a five-year transition period under the final rule would serve that goal.

4.) <u>The Board should Recognize an Exemption From the Prior-Notice Requirement if the Effect of the Distribution Would be *de minimis*, Even if it Exceeds a Prior Filed and Approved Plan.</u>

We respectfully suggest that, if in making a capital distribution, an SLHC would exceed the dollar amount of the capital distribution described in the capital plan previously filed and approved by the Board, the Board should grant a blanket exemption from the notice requirement if the excess over the previously filed and approved amount or the actual distribution would be *de minimis*.

Such an exemption would properly recognize substance over form, avoid unnecessary potential for disruption of a distribution transaction and have nominal impact upon the statutory objective of preservation of the holding company's source of strength. In our view, if the distribution would not reduce the holding company's Tier 1 Risk Based Capital by 10 basis points or more, the holding company should be exempted from a prior-notice requirement.

<u>Conclusion</u>

In summary, we believe that the purpose behind the proposed rule can be met, and unnecessary costs and burdens can be avoided, by exempting large SLHCs with small depository institutions from the formal capital plan requirement. Nationwide

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encourages the Board to use existing supervisory tools to address the potential risks posed by such companies. In determining if a large SLHC owns a small bank or should otherwise be exempt from the capital plan requirement, we recommend that Board adopt an objective test, as described above. We also believe that imposing the requirements on SLHCs that are operating mutual insurance companies could unnecessarily create conflicts with state insurance laws directed at policyholder rights. Finally, an exception for insurance company SLHCs that own small banks would eliminate issues regarding the comparability of the data to holding companies with large banks.

As always, we appreciate the dialogue and look forward to further opportunities to comment.

Very truly yours,

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