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October 22, 2012

The Honorable Thomas J. Curry
Comptroller
Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, S.W.,
Washington, DC 20219

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20551

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW.
Washington, DC 20551

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (FRS Docket No. R-1438 & RIN 3064-AD95); Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (FRS Docket No. R-1442 & RIN 3064-AD96); Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule (FRS Docket No. R-1442 & RIN 3064-AD97)

Dear Sirs:

On behalf of Mutual of Omaha, we appreciate the opportunity to provide information in response to the three joint notices of proposed rulemaking (the "Proposals") referenced above. As a mutual insurance company that is also a savings and loan holding company (SLHC), we have numerous concerns about the manner in which the Agencies may exercise regulatory authority over our organization. With this letter, we would like to focus on our particular concerns about the adverse consequences that will result if bank capital standards are applied to insurers, as the Proposals currently stand. We provide commentary for your consideration specific to the particular activities of insurance companies, methodology and risk charges and the congressional requirement that the agencies appropriately accommodate the business of insurance in their implementation of these rules.

Mutual of Omaha is a member of the Financial Services Roundtable (FSR) and the American Council of Life Insurers (ACLI), and we fully support the comments recently submitted by both of these associations with regard to the impact of the Proposals on both our insurance and our banking operations. In particular, we support the ACLI's call for a quantitative impact study prior to adopting the rules as proposed. There are a number of areas where there is a lack of understanding of the insurance business model where the proposals would lead to numerous unintended consequences. We are intensely focused on the impact of the Proposals on insurers affiliated with insured depository institutions and assert:

- The Agencies should defer to state risk-based insurance capital standards for insurers that are also holding companies;
- There are other, more appropriate alternatives to the bank-centric uniform approach;
- The Agencies must, at the very least, refine the Proposals for appropriate treatment of the assets and exposures of insurance companies; and
- Application of any new capital standards to SLHCs should occur in 2015, not 2013.

We would reference the information provided in the ACLI and FSR commentary in regard to the special characteristics of insurance companies and would like to offer the following additional comments for your consideration.

Background:

The Senate Report accompanying the Dodd-Frank Act called for the Agencies to "take into account regulatory accounting practices and procedures applicable to, and capital structure of, holding companies that are insurance companies (including mutual and fraternals)" (See S. Rep. No. 111-176 (2010)). These directives have been reiterated in recent Senate briefings and in the bipartisan Senate Letter submitted to your Agencies on October 17, 2012.

Over the past two years, the Agencies have sought public comment on multiple occasions seeking information on the unique characteristics, risks or specific activities of holding companies that are insurance companies that should be taken into consideration when developing consolidated capital requirements for these entities. Despite receiving a large number of responses clearly substantiating the need and importance for an appropriate capital regime, the Agencies continue to put forth bank-centric proposals that do not align with the business of insurance.

The Proposals claim to take into consideration the unique characteristics, risks and activities of holding companies that are insurers. They further assert that a uniform approach for insurers that are holding companies would "mitigate potential competitive equity issues, limit opportunities for regulatory arbitrage, and facilitate comparable treatment of similar risks." (See Standardized Rule, page 95). However, all evidence actually points to the contrary.

We recognize the Agencies' efforts to interpret and implement the provisions of the Dodd-Frank Act related to capital requirements. In their proposed form, however, the Proposals need significant modifications in order to accommodate the business of insurance and prevent unintended consequences for those customers and policyholders of insurers that are also holding companies.

While the Agencies claim a uniform approach would simplify its review, the industry has repeatedly illustrated how it would only serve to complicate any regulatory review. Moreover, we believe it will impose significant and costly compliance burdens and unintended consequences for legitimate insurance operations, their affiliates and the communities they serve. Specifically, we believe the capital provisions were not intended to impair or impede insurance company operations. Insurance companies are subject to effective and long-standing state investment laws that are specifically designed to promote the safety and soundness of regulated insurance companies through particular measures like investment limits and diversification requirements. The insurance company model, as has been demonstrated repeatedly as Dodd-Frank Act implementation has developed, is different from other financial institution models in, among other ways, its focus on supporting long-term liabilities with long-term assets and investments. To appropriately accommodate the business of insurance, recognition of some of its fundamental characteristics must to be taken into account within the drafting of the Basel III capital requirements.

DISCUSSION

I. The Agencies should apply the principle of equivalency to an insurer that is also a holding company to determine whether it is adequately capitalized under its state insurance regulator and take corrective action if it is not.

As an insurance company, Mutual of Omaha is subject to stringent, time-tested regulatory capital standards imposed by state insurance regulators. As a savings and loan holding company, we are also subject to the prudential capital requirements of the OCC as part of its consideration of the holding company as a "source of strength" for the depository institution. In order to address the discrepancies between bank and insurance capital rules, we believe the most appropriate way to craft regulatory language is to reflect an insurer's risk-based capital standard equivalent. This standard should clarify that as long as a mutual insurer meets its state regulator's capital requirements it would be deemed to be in compliance with bank capital requirements. If it fails to meet its state regulator's capital requirements or, upon specific findings that such requirements are inadequate, the Federal Reserve could intervene and impose a capital standard on that particular insurer. Such a standard would not diminish the Board's authority to act as a consolidated regulator, impose additional capital standards or require that a mutual insurance company that is organized as a bank holding company or savings and loan holding company act as a source of strength for a subsidiary insured depository institution.

II. Should the Agencies decide not to apply the equivalency principle, there are still other, more appropriate, alternatives to the bank-centric uniform approach.

Risk-based capital (RBC) is a well-tested mechanism to reflect the underlying risks of an insurance enterprise. We're familiar with the approach outlined in the ACLI's comment letter (dated October 12, 2012, Appendix AA), and believe that, if done properly, the use of RBC risk charges to derive "imputed risk weighted assets" for an insurer will lead to a better, more accurate risk assessment for insurance operations than a bank-centric asset-only approach.

We agree that consolidated GAAP equity, if available as part of an audited financial statement, forms a better starting place for a capital definition than the more conservative statutory basis. For complex organizations, it presents a consolidated picture of the total financial condition of the enterprise.

However, the capital rules need not force an entity that does not report on a GAAP basis to adopt GAAP. Those companies that utilize SAP accounting should be permitted to continue to rely upon those standards, as the statutory equity of all subsidiaries would still be reflected in the statutory surplus of the ultimate parent. What we recommend is the use of GAAP, *if audited GAAP financials* *exist*, with the permission to use SAP for those few companies that do not have audited GAAP financial statements. To avoid regulatory arbitrage, Federal Reserve approval should be required to stop doing GAAP once started for those companies for which GAAP may be optional (for example, mutual insurance companies).

III. Further Modifications to the Treatment of the Assets and Exposures of Insurance Companies are Necessary to Appropriately Accommodate the Business of Insurance.

Should the Agencies fail to adopt an RBC method similar to that put forth by the ACLI, we're comfortable using ratios of capital to risk weighted assets as the measure of risk based capital, if modifications to some of the proposed definitions are made.

Overstated Insurance Risks

We believe that deducting all minimum RBC from regulatory capital reflects a double count of the asset risk. As other comment letters from the industry have pointed out, RBC reflects a risk charge for credit risk and asset/liability mismatch risk already, so leaving insurer-owned assets in the risk weighting, as well as deducting the insurer capital held to back that risk, unduly punishes insurers.

Insurer RBC is comprised of four broad components. We would agree that the charges for insurance risk (the so-called C-2 risk charge for pricing and claim risks) and for other non-asset related risks (the so-called C-4 risk charge for other risks, which is derived from paid premiums) could be appropriately used in the proposed framework, either as a direct deduction from capital or used to compute some imputed risk weighted assets to add to the denominator of the standard calculation. However, as proposed, the calculation overstates insurance risk.

Corporate Bonds

The proposals currently provide that "other corporate exposures" (such as corporate bonds) receive the same 100 percent risk weighting as commercial and industrial (C&I) bank loans. We think that that risk weighting for corporate bonds is wrong. Our own analysis suggests a risk weighting of 50 percent or less for corporate bonds would be appropriate. At the very least, the Agencies should conduct a quantitative impact study, as advocated by the ACLI, to understand whether this equivalence correctly captures the risk of the different asset classes and whether a misallocation of risk weight materially distorts the apparent capital position of the insurer and could be damaging to the economy.

Our analysis of loan charge-off data from the Federal Reserve website suggested that the average loss on C&I loans over the reporting periods available was 92 basis points. The average loss derived from some Moody's data on a reasonable portfolio of corporate bonds (90 percent investment grade, 10 percent non-investment grade) over a similar time period was 33 basis points. On the surface, this suggests less risk of loss in bonds than loans. However, another measure of risk is the deviation from expected. The largest reported loss in the Federal Reserve's data on C&I loans for the industry was 266 basis points. The largest reported loss from the Moody's data on the bond portfolio was 112 basis points. Both the "worst loss" and the "worst deviation from the average loss" show bonds with a risk profile less than 50 percent of that of C&I bank loans.

We recognize the long-standing practice in bank capital measures to hold these two asset classes to the same risk weight. In the case of banks, the overstatement of risk of loss on corporate bonds is immaterial given that such a small percentage of their assets are typically in corporate bonds (less than 6 percent in recent periods as derived from data on the Federal Reserve's website). In contrast, insurers have on average almost 50 percent of their assets in corporate bonds. What may be an immaterial issue for most banks is very material for insurers and misrepresents the risk of an insurer's assets. Although our analysis is not intended to be viewed as definitive, it does illustrate how a much more rigorous analysis is needed. A quantitative impact study would provide this important review.

Another rationale for the long-standing practice in the banking industry of equivalent risk weights is that the typical role that banks are intended to play in financing businesses is to make loans, not to buy securities. By placing an over-weight on the risk level of bonds, the capital rules have encouraged that fundamental role of banks. In contrast, insurers with their long dated liabilities are the perfect financial entity to invest in longer dated fixed income instruments that match those liabilities. This allows them to fulfill a very valuable role in the economy as the source of permanent debt financing, which adds to the financial stability of those borrowers. Adopting rules that would overstate the risk of corporate bonds may have the unintended consequence of limiting this source of long term capital to the economy.

A different, but related problem with the proposals is the inclusion of unrealized gains and losses on available for sale securities in the capital measure. As an appropriate risk mitigation technique, insurers match their longer duration liabilities with longer duration assets. On an economic basis, both the values of assets and liabilities change with changes in the interest rate environment. But the current financial reporting rules "lock in" the value of the liabilities and they don't move for existing policies based on current changes in interest rates. But asset valuations do. Marking one side of the balance sheet to market and not the other side leads to volatility in capital if those asset marks are included. Historically, they have not been included in bank capital rules and we would advocate for that practice to continue. Given the longer duration of assets for an insurer due to their longer liabilities, the problem is more acute for insurers than banks, though it's also problematic for banks.

Promulgation of the rules as proposed would incent insurers to invest shorter-term and risk the mismatch against their liabilities. That would likely increase rather than decrease risk. Lowering the asset duration along with dis-incenting investing in corporate bonds would further limit an insurer's desire to be a source of long-term permanent debt financing to American businesses. These proposed rules risk doing more economic damage than the benefit to be gained by their application to insurers that are BHCs or SLHCs. Bonds should be given a lower risk weight than C&I bank loans and unrealized gains and losses should not impact regulatory capital.

Separate Accounts

The rules defining "non-guaranteed" separate accounts are too narrow. It is common to have features that produce general account reserves, but are typically low risk and not related to offering any form of investment return guarantee. Simply guaranteeing a return of a deposit at death if greater than the account value is a common, but low risk option reserved for in the general account. Having a variable life or annuity policy can generate general account reserves for the death benefit feature, but also doesn't guarantee returns of the underlying funds. We'd advocate clarifying that such simple benefit offerings would still be classified as "non-guaranteed" separate accounts and exclude them from risk weightings. We also believe they should be excluded from total assets in leverage ratios. Non-guaranteed separate accounts are more like trust accounts or other "assets under management". They are technically owned by the insurer for legal and tax reasons, but the asset-related risk is no different than funds held by banks in trust accounts (which are excluded from leverage tests).

IV. Any new application of capital standards to SLHCs should occur no earlier than 2015.

Section 171 of the Dodd-Frank Act (also known as the "Collins amendment") requires the Agencies to establish minimum risk-based capital and leverage requirements for insured depository institutions, their holding companies, and non-bank financial companies subject to supervision by the Board. These minimum requirements are not to be less than the standards applicable to insured depository institutions as of July 21, 2010.

Previous Agency proposals have acknowledged the fact that certain depository institution holding companies now subject to Section 171 had not previously been subject to bank capital requirements and may hold assets that do not have a specific risk-weight assigned under generally applicable bank risk-based capital requirements (See, Federal Reserve's Joint Notice of Proposed Rulemaking on Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor, FRB Docket No. R-1402 section I.E. "*Effect of Section 171 of the Act on Certain Institutions and Their Assets*"). Given the operational and systems changes necessary to comply with such requirements, Congress expressly delayed the application of the Collins amendment to SLHCs for five years.

Section 171(b)(4)(D) reads as follows:

> (D) DEPOSITORY INSTITUTION HOLDING COMPANIES NOT PREVIOUSLY SUPERVISED BY THE BOARD OF GOVERNORS. – For any depository institution holding company that was not supervised by the Board of Governors as of May 19, 2010, the requirements of this section, excepts as set forth in subparagraphs (A) and (B), shall be effective 5 years after the date of enactment of this Act.

The clear intent of the Collins amendment was to make newly covered entities such as SLHCs exempt from this capital framework until five years after Dodd-Frank adoption, so July 21, 2015. However, the Agencies appear to have disregarded the delayed effective date for the application of capital standards to SLHCs in the current proposals. While the Agencies have the general authority under HOLA to impose new capital standards on SLHCs prior to 2015, statutory precedence obliges the Agencies to give effect to every word in the statute (Congress is presumed to know how to write laws), and specific terms in the statute override general terms. (*See Astoria Federal Savings & Loan Ass'n v. Solomino*, 501 U.S. 104, 112 (1991); *Fourco Glass Co. v. Transmirra Products Corp.*, 353 U.S. 222, 228 (1957). As such, the additional time in which to comply is not only greatly needed for the policy, procedural and systems changes necessary to comply with any new standard, it is, in fact, mandated by the Dodd-Frank Act.

CONCLUSION

Proper accommodation of the business of insurance requires that insurance companies affiliated with banking entities have a system aligned with the unique characteristics, activities and risks of the insurer under the purview of the Federal Reserve's capital framework. It also requires recognition of the validity of the existing state insurance regulatory regime. We would again reiterate our support of the comments submitted by the ACLI and Financial Services Roundtable. We would also refer to the bipartisan Senate Letter regarding Basel III, submitted to your Agencies on October 17, 2012, reaffirming the will of Congress that the Agencies respect the distinctions between insurance and banking.

Given the complexity of this issue, we ask that the Agencies refrain from promulgating final rules until after any possible Senate hearings on Basel III during the lame duck session to ensure consideration of all issues.

Once again, we appreciate the opportunity to comment on this very important issue and are available for further discussion at your convenience. Thank you for your consideration.

Respectfully submitted,

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Mutual of Omaha