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October 18, 2012

VIA EMAIL

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

Re: Docket No.R - 1442
RIN 7100 AD 87

Dear Ms. Johnson:

We are writing on behalf of a number of diversified savings and loan holding companies ("SLHCs"). Our letter comments on proposed capital rules that would, if adopted, require SLHCs to hold minimum amounts of capital, and, thus, the companies that we represent would be directly and significantly affected by the proposed rules.

The Process Should Provide a Separate Diversified SLHC Capital Rulemaking.

The proposed rules contain very little discussion or analysis of how SLHCs, particularly diversified SLHCs, would be affected by the proposals; indeed, the very serious concerns of insurance SLHCs are dismissed in only a couple of paragraphs out of more than seven hundred pages of text.

The scope of the proposed rules is to apply to all bank holding companies, banks, SLHCs, and savings banks. The proposed rules implement various agreements reached by bank regulators from around the world. Many aspects of the proposal are quite controversial to the banking industry generally. Pointedly, our clients believe it is a shame that their very serious, unique concerns with the general concept of having bank-like capital requirements imposed on them with little notice and little discussion are to be considered in what, in essence, are the shadows of very significant issues that will be raised by the banking industry.[1] The concerns our clients have with the threshold issue of the imposition of capital requirements at all have been given scant consideration and the process that the Board is following promises that not much more focus or attention will be given those issues.

Nowhere is that better illustrated than in the Notices of Proposed Rulemakings' failure to discuss the effective date of the imposition of capital requirements on SLHCs. There is no explicit or implicit discussion or analysis of the fact that proposed regulation (Section 217.30(b)) itself is being construed as imposing capital requirements on SLHCs immediately. Similarly, there is no discussion whatsoever of substantial accounting concerns that insurance SLHCs have raised, and, also, there is no discussion of problems that mutual SLHCs have raising equity capital. Further, there is no discussion of the complexities that insurance SLHCs would face conforming to both existing state insurance regulatory capital requirements and the proposed capital requirements. These are enormous and extraordinarily costly issues to diversified SLHCs, and they deserve very careful attention, thought and consideration. The Notices of Proposed Rulemaking reflect no consideration of these extremely serious issues, and they should not be lost in the maw of many greater issues affecting the entire banking industry.

Another policy challenge unaddressed by the proposed rules is the impact the proposed rules may have on large diversified SLHCs with relatively small thrift subsidiaries, where the holding company's activities are international and include manufacturing and sales activities. The proposed advanced approaches capital rule imposes the advanced approach on any SLHC with consolidated total on-balance sheet foreign exposure of $10 billion or more. Some diversified SLHCs engage in major international manufacturing and sales activities giving rise to foreign exposure of more than $10 billion. It appears that such an SLHC must immediately comply with the complex Basel III requirements of establishing sophisticated models to rate the risk of individual assets, essentially having to create a risk-rating regime equivalent to those utilized by the largest banks in the world, no matter how small its subsidiary thrift. We do not believe the proposed rules intended this type of result, not would such a result be appropriate without any additional analysis or explanation.

We, therefore strongly urge the Board to re-propose a more carefully considered requirement to apply capital requirements to diversified SLHCs.

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[1] Those general significant concerns are expected to range from international competitive disadvantages to which U. S. banking organizations may be put, the treatment of foreign sovereign obligations, definitions of terms such as "financial institution" and "high volatility commercial real estate," how the rules will interface with the pending Volcker Rule, grandfathering of existing instruments, treatment of trust preferred stock, treatment of securitizations, bases for risk ratings, the need for a quantitative impact study, disregard of recoveries, recognition of PMI, exposures to securities firms, past due exposures, OTC derivatives, collateralized transactions, etc.

Options that might be considered in such a separate rulemaking might include recognizing and encouraging the establishment of intermediate holding companies by certain diversified SLHCs and only applying capital requirements to the intermediate holding companies. Another might be to consider, even though the Board in the Standardized Approach Notice has rejected arguments that the small relative size of a savings bank should be considered, exempting SLHCs where the savings bank is less than 20% of total consolidated assets of the parent diversified company so long as a form of capital maintenance commitment or agreement is in place. In some cases, that commitment or agreement would be from the parent, but, in some cases, where the actual source of strength in an organization is not the shell parent, but rather a large operating affiliate, the commitment or agreement might come from that affiliate.

The concerns of diversified SLHCs are very serious and entitled to very careful, thoughtful consideration. The FRB should consider these complex concerns may only be soluble by innovative creative solutions rather than the crude, simplistic, forcible imposition of general rules applicable to all banking organizations that simply do not fit well.

The Proposed Rules Frustrate the Will of Congress.

Congress, in its consideration of the Dodd-Frank Act, considered eliminating the thrift charter and SLHCs altogether. Indeed, the bill that eventually was enacted initially eliminated that charter and SLHCs altogether. However, as the bill worked its way through Congress, decisions were made to retain the thrift charter and SLHCs, as the current law reflects. To the extent that provisions that would have eliminated the thrift charter and SLHCs were removed from the bill, Congress consciously expressed its intention to preserve the charter and SLHCs.

That is in no way surprising. Generally, diversified SLHCs did not cause nor contribute to the financial crisis. To the contrary, diversified SLHCs, particularly insurance companies, have been towers of strength, contributing needed capital during the crisis.

Nonetheless, in giving the SLHC industry such short shrift in the Notices of Proposed Rulemaking, some in the industry believe that the Board may have made a conscious decision to eliminate diversified SLHCs by encouraging diversified SLHCs to divest their thrift subsidiaries to avoid the costs and burdens of the proposed rules. The Notices would make operating a diversified SLHC, particularly one in which the savings bank subsidiary is a small part of the organization, prohibitively expensive. Even today, before the adoption of the proposed rules, diversified SLHCs are actively divesting their savings banks in order to avoid the expense of SLHC status. Allstate Insurance Company dissolved its federal savings bank. Thrivent Financial for Lutherans is endeavoring to convert its savings bank to a credit union. Ameriprise has just announced that it is terminating the deposit activities of its savings bank in order to avoid SLHC status. The costs imposed by the proposed rules would accelerate that trend, e.g. imposing capital requirements on insurance company assets, but not counting insurance company capital, a concept so one-sided and unbalanced that some consider it punitive.

The Effective Date of Basel I Should be Delayed for Diversified SLHCs.

The version of the proposed Standardized Approach that appeared in the Federal Register, in section 217.30(b) provides "[o]n or before December 31, 2014, the [BANK] must calculate risk-weighted assets under either: (i) The methodology described in the general risk-based capital rules ... or (2) Subpart D of this part." Literally, that means that an SLHC may calculate risk-weighted assets under either method before December 31, 2014 or, alternatively, on December 31, 2014. Thus, an SLHC that has never before had to risk-weight assets under the Basel I rules could do so before December 31, 2014 or on December 31, 2014. That makes considerable sense from a policy perspective as it would give SLHCs that have never had to calculate risk-weighted assets before, two years to learn how to do so and to program and test systems. Although some of our diversified SLHC clients have suggested that two years may well not be sufficient, that language does reflect a recognition of the serious problems that diversified SLHCs will face in calculating risk-weighted assets.

The language of section 217.30(d) originally considered by the Board read slightly differently, essentially providing that "[u]ntil [January 1, 2015], a [BANK] may calculate risk-weighted assets using the methodology described in the general risk-based capital rules...." While that language appeared to mean that an SLHC need not calculate risk-weighted assets until January 1, 2015, we were advised that the Board's staff did not interpret that language that way, but, instead, took the position that an SLHC would have to calculate risk-weighted assets upon adoption of the rule and that the language would be revised in the Federal Register notice to reflect that.

However, as explained above, the Federal Register notice language appears literally to provide that an SLHC can wait until December 31, 2014 to calculate risk-weighted assets which addresses the policy concerns that many SLHCs have. Nonetheless, perhaps because of the Board's staff's earlier position, some are disregarding the literal language in the Federal Register notice in the belief that, despite the literal language permitting an SLHC to calculate risk-weighted assets on December 31, 2014, it is the intent of the Board's staff that an SLHC calculate risk-weighted assets immediately upon adoption of the proposed regulation.

While the narrative portion of the Notices does not specifically address the effective date of the proposals for SLHCs, requiring all covered firms to comply with Basel I rules immediately or on January 1, 2013, when the proposed Basel III proposal becomes effective, at the latest, would impose an enormous and unfair burden on SLHCs and violate the Collins Amendment. Without any discussion or analysis, the Board would impose an extraordinarily complex bank-like capital regime on an entire industry, including manufacturing companies, insurance companies, securities firms, and retailers, immediately, giving the industry no time to prepare, to make systems investments and adjustments, or change accounting systems.

When the original Basel I requirements were adopted in 1989, the Board did not require that bank holding companies immediately comply. Instead the Board phased in the requirements over three (3) years giving bank holding companies time to develop systems, raise capital, and reduce assets. In 1989, bank holding companies on which the rules were being imposed had been regulated by the Board for 33 years; when the instant proposals were issued, SLHCs had been subject to Board regulation for less than a year. SLHCs should be given no less an opportunity to comply with capital requirements in an orderly careful manner now than long-regulated bank holding companies were given in 1989.

When all of the problems diversified SLHCs would face in complying with these requirements are considered, the case against immediate effective date becomes even stronger. Those problems include changing accounting systems, reconciling conflicting capital requirements imposed by state insurance regulators, and overcoming problems imposed by corporate structure in the case of mutuals; all are problems the banking industry did not have to deal with in complying with the Basel I capital requirements in 1989,

Apart from disregarding the burdensome costs that would be imposed by making these requirements immediately effective, the Board, in doing so, also disregards transitional timing provisions specifically set forth in the Dodd-Frank Act. The Collins Amendment, under which the Board purports to be acting in these proposals, expressly provides, in Section 171(b)4)(D), that minimum capital requirements established on a consolidated basis for depository institution holding companies not supervised by the Board as of May 19, 2010, such as SLHCs, shall be effective on July 21, 2015. This coincides with the roughly three year time period that the Board gave bank holding companies to comply with the original Basel I requirements in 1989. Thus, to the extent that the Board's capital proposals would be effective as to SLHCs upon adoption or on January 1, 2013, they would appear to violate the effective date provisions of the Collins Amendment. The Dodd-Frank Act was enacted by a very close vote of Congress, and every provision was carefully and extensively considered and negotiated including the Collins Amendment and its effective dates. The Board should not disregard the agreements reached by Congressmen in enacting contested pieces of legislation.

The Board may consider that it is free to disregard the effective date requirements of the Collins Amendment because Congress, in Section 616(b) of Dodd-Frank, amended HOLA to give the Board authority to establish capital requirements for SLHCs and did not provide a 2015 effective date for that authority. However, the intent of Section 616(b) was merely to conform HOLA to the transition of authority from the Office of Thrift Supervision to the Board and, in any event, to authorize the establishment of capital requirements by rule and not , in any way, to establish an independent capital requirement separate and apart from the Collins Amendment. Thus, the Board in the instant proposals repeatedly cites the Collins Amendment as the basis for the proposals. In any event, if Section 616(b) provided a source of authority separate from the Collins Amendment and thus the Board would not be bound by the effective date requirement of the Collins Amendment, the instant proposal would be required to conform to all of Section 616(b) including its requirement that the Board and other agencies seek to make the capital requirements countercyclical. The instant capital proposals are not countercyclical, they do not purport to be countercyclical, nor do they even discuss this requirement of Section 616. Thus, it would appear that claiming to act under the authority of Section 616(b) would not be valid here and thus the Board is not entitled to disregard the July 21, 2015 effective date required of the consolidated capital requirements of the Collins Amendment.

Finally, while the Board proposes to disregard the July 21, 2015 effective date for capital requirements imposed pursuant to the Collins Amendment in the case of SLHCs, the Board has proposed to follow a similar effective date mandate in the Collins Amendment in the case of bank holding companies controlled by foreign banks. Section 174(b)(4)(E) of the Collins Amendment contains an effective date provision for such bank holding companies identical to that for SLHCs, i.e. July 21, 2015. The regulations that the Board has proposed for foreign-controlled bank holding companies would be effective January 1, 2015. Thus, the Board proposes to give foreign-controlled bank holding companies almost three years to comply, but has given domestic SLHCs no time to comply. We respect the need for comity with foreign countries and for national treatment; however that need does not preclude the Board from treating domestic firms at least as well as foreign-controlled firms.

We urge the Board to give SLHCs until July 21, 2015 to comply with new capital requirements.

<u>The Board Needs to Address the Particular Problems that Mutuals Would Have in Raising Capital.</u>

By definition, mutual SLHCs do not have the capacity to raise common equity by selling stock. They can only build equity capital by retaining earnings, a comparatively slow process.

It is in that context that the Board should consider encouraging the establishment of an intermediate holding company which could quickly raise capital by selling stock and only applying the capital requirements to such firms. Again, source of strength considerations could be met by requiring parent or affiliate guarantees or capital maintenance agreements and the parent's or affiliate's maintenance of certain levels of lines of credit or letters of credit from third-party commercial banks.[2]

Instead, the Board goes in the opposite direction and proposes that surplus notes issued by insurance companies would not count as Tier 1 capital. We respect the Board's concern with the integrity and strength of Tier 1 capital; however, in weighing the costs of declining to treat surplus notes as Tier 1 capital against the benefits, at least in the limited case of mutual insurance company SLHCs, it is not unreasonable for the Board to compromise its high standards here where there is no other alternative way for mutual insurance companies to raise equity. Mutual insurance companies do not use that form of corporate structure to gain competitive advantage, and it is not likely that stock holding companies would change their form of ownership to mutual in order to game the system and gain competitive advantage in order to get Tier 1 capital credit by selling surplus notes.

The Board Should Permit Insurance SLHCs to use Statutory Accounting Principles.

Non-publicly-held insurance companies are required by state law to utilize statutory accounting principles ("SAP"), instead of generally accepted accounting principles (GAAP). SAP is generally considered to be more conservative than GAAP as SAP is calculated based on liquidation values.

One small mutual insurance SLHC client of ours has been told that it would cost it $12 million to convert to GAAP. Another larger mutual insurance company client has been told that the cost to convert to GAAP would be in the hundreds of millions of dollars.

The proposals do not explicitly require GAAP accounting, but such a requirement is implied in various provisions of it.

The Board should directly address this issue and also should not put mutual insurance SLHCs to the extraordinary costs of converting to GAAP; the benefits of converting to a less conservative accounting system are non-existent and simply do not outweigh the heavy conversion costs. That is even more true in cases in which the size of the savings bank subsidiary is less than 20% of the total assets of the insurance company.

The Board Should Either Include All Insurance Subsidiary Capital or Exclude Insurance Subsidiary Assets.

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[2] In some cases, the parent might not be the ultimate source of strength as a practical matter, e.g. where there is a shell holding company over both the thrift and a large operating company; in such cases, the large operating affiliate, as the actual source of strength in the overall organization, should be looked to as the source of strength for the thrift.

The proposal reflects concern that insurance subsidiary capital is there to absorb insurance risk. Therefore, it proposes that a substantial amount of insurance subsidiary capital be deducted from a company's consolidated capital in calculating compliance with the proposed capital requirements. The proposal does not propose a corresponding deduction of insurance subsidiary assets.

This disregards the fact that insurance company capital, of course, is not only available to absorb insurance losses, but also is available to absorb losses caused by realization of credit risk on the assets held by an insurance company. Capital, of course, is available to absorb losses from multiple risks. Bank holding company capital absorbs losses deriving from credit risk, market risk, operational risk, etc. Since insurance subsidiary capital is available to absorb credit risk, it should be counted as capital and not deducted from enterprise-wide capital.

However, if the Board does require deduction of insurance subsidiary capital, it should also permit deduction of insurance subsidiary assets supported by that capital. Today, state insurance regulators, who have done an impressive job in protecting the safety and soundness of the industry they regulate, impose capital requirements that are very conservative. Those capital requirements protect not only against insurance risk, but also against credit risk. State insurance capital requirements are risk-based based on asset quality. The Board historically has, with the national state insurance regulator trade association, conducted comparative studies of bank and insurance company capital requirements. Those studies have not found deficiencies in state insurance capital requirements. Since state insurance capital requirements cover credit risk of assets, if the Board is to require deduction of capital that covers asset credit risk, there is no reason to require that the assets covered by that capital should be treated as if they have no capital support; rather, if their supporting capital is to be deducted, those assets should also be deducted.

Conclusion

The application of the Board's capital proposals to diversified SLHCs is not precedented and raises numerous very serious novel and tendentious issues that sincerely concern many diversified SLHCs that honestly wish to continue to provide limited banking services to their clients and customers. The proposals do not address these very significant issues, and diversified SLHCs are concerned that as serious as they feel these issues are, their voices and concerns will be drowned out by the many substantive comments that the Board will receive as the proposals seek to impose Basel III on the U. S. banking system and to revise 23 years of Basel I practices as it considers the new Standardized Approach to risk weighting of assets.

The concerns of diversified SLHCs regarding immediate effective date, problems of mutuals, accounting, and treatment of insurance company capital, seriously as they are held, are of an entirely different nature than the concerns that will be voiced by the banking industry over Basel III and the new Standardized Approach. The concerns of diversified SLHCs would be better heard and more thoroughly considered were application of these rules to them severed from the proposals and separately proposed and considered.

Thank you for the opportunity for us to express our views and those of our clients on the proposals.

Respectfully submitted,

Christine A. Edwards

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