THE FINANCIAL SERVICES ROUNDTABLE
Financing America's Economy

American Bankers Association
Building Success. Together.

October 22, 2012

By electronic submission

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
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250 E Street, S.W.
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Re: Regulatory Capital Rules:

Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (OCC Docket ID OCC-2012-0008, RIN 1557- AD 46; FRB Docket No. R- 1442, RIN 7100 – AD 87; FDIC RIN 3064-AD95);

Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements (OCC Docket ID OCC-2012-0009, RIN 1557 – AD 46; FRB Docket No. R- 1442, RIN 7100 – AD 87; FDIC RIN 3064-AD96); and

Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule (OCC Docket ID OCC-2012-0010, RIN 1557 – AD 46; FRB Docket No. R- 1442, RIN 7100 – AD 87; FDIC RIN 3064-AD97)

Dear Sir or Madam:

The Financial Services Roundtable[1] and the American Bankers Association[2] (collectively the "Associations") appreciate the opportunity to comment on the proposed rules to implement the risk-based capital, leverage, and market-risk features of the Basel III

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs. For more information, visit The Financial Services Roundtable's website at www.fsround.org.
[2] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees.

capital framework[3], the standardized approach in the Basel II capital framework[4], and certain features of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[5], including section 171 of that Act, (collectively the "Proposed Capital Rules"), which have been jointly proposed by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "Agencies").

This letter addresses the application of the Proposed Capital Rules to savings and loan holding companies. In particular, those unitary and other savings and loan holding companies, including insurance companies, that are operating companies. The Associations recognize the need for savings and loan holding companies to have sufficient capital resources to absorb losses in the event a company encounters financial problems. The financial crisis demonstrated the importance of capital as a buffer against both institutional and systemic risks.

However, the Associations have serious reservations with the proposed uniform approach to capital standards for savings and loan holding companies, which are based upon the standards originally created for bank holding companies. We believe that the Agencies should tailor applicable rules to the characteristics, activities, and risks of the diverse range of savings and loan holding companies.[6] We also believe that the Proposed Capital Rules do not give full effect to the terms of section 171 of the Dodd-Frank Act, including the delayed effective date for the application of capital standards for savings and loan holding companies, and this creates additional compliance burdens for savings and loan holding companies.

Based upon these concerns, the Associations recommend that the Proposed Capital Rules be modified to –

- Provide for the application of capital standards to savings and loan holding companies as of July 21, 2015, not 2013;
- Permit savings and loan holding companies to comply with a tailored approach to capital that is based upon the principal of equivalency for savings and loan holding companies that are subject to other capital regimes (such as state risk-based insurance capital standards) or is directed to an intermediate holding company;
- Grant small savings and loan holding companies the same general exemption proposed for small bank holding companies;
- Grandfather trust preferred securities issued before May 19, 2010 by savings and loan holding companies with less than $15 billion in assets;

[3] *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, Basel Committee on Banking Supervision.
[4] *International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, Basel Committee on Banking Supervision.
[5] Pub. L. No. 111-203.

- Maintain the accumulated other comprehensive income filter;
- Avoid overly conservative capital standards for residential mortgages, which constitute a significant portion of the savings and loan assets.
- Conduct an empirical study of the impact of the proposed capital standards for residential mortgages in order to develop standards that do not overly restrict mortgage lending and needlessly impair economic growth.

The remainder of this letter is divided into five sections. Section I addresses the Agencies' proposed uniform approach to holding company capital, and urges the Agencies to consider alternative approaches that are better aligned with the distinctive character of savings and loan holding companies. Section II addresses the Agencies' interpretation of section 171 of the Dodd-Frank Act, and maintains that the Agencies cannot ignore certain provisions in section 171 that apply to savings and loan holding companies, including the delayed effective date for the application of capital standards to savings and loan holding companies. In Section II, we also urge the Federal Reserve Board to exercise its discretion to exempt small savings and loan holding companies under $500 million in consolidated assets from the Proposed Capital Rules, consistent with the exemption for small bank holding companies of a similar size. Section III addresses the proposed treatment of certain assets and exposures held by insurance companies that are savings and loan holding companies. That discussion highlights the problems inherent in applying a capital regime designed for bank holding companies to savings and loan holding companies that are insurance companies. In sections IV and V, we address the proposed treatment of accumulated other comprehensive income and residential mortgage exposures, respectively.

I. The Agencies Should Consider Tailored Capital Standards for Savings and Loan Holding Companies

In an April 2011 Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies (the "Notice of Intent"), the Federal Reserve Board (the "Board) signaled that it was considering applying to savings and loan holding companies the same consolidated risk-based and leverage capital requirements that apply to bank holding companies. In that Notice of Intent, however, the Board stated that it would do so only "to the extent reasonable and feasible taking into consideration the unique characteristics of savings and loan holding companies and the requirements of [the Home Owners' Loan Act]...",[7] and the Board acknowledged the potential disconnect between the capital standards designed for bank holding companies and the operations and activities of the savings and loan holding companies: "[Savings and loan holding companies] have traditionally been permitted to engage in a broad range of nonbanking activities that were not contemplated when the general leverage and risk-based capital requirements for [bank holding companies] were developed."[8]

[7] 76 Fed. Reg. 22665 (Apr 22, 2011).
[8] Id.

The Notice of Intent invited public comment on the "unique characteristics, risks, or specific activities of savings and loan holding companies that should be taken into consideration when developing consolidated capital requirements for these entities."[9] In response to this request, the Board received several letters from savings and loan holding companies that addressed the unique characteristics, risks, and special activities of savings and loan holding companies. For example, Macy's Inc. noted that it is engaged in a business that is fundamentally different in terms of the nature of its assets, liabilities and capital structure than a bank holding company;[10] TIAA-CREF noted that the threats posed by savings and loan holding companies to the stability of the financial system are very different than those posed by bank holding companies;[11] and Nationwide Mutual Insurance Company noted that it has grandfathered powers that enable it, unlike a bank holding company, to engage in any type of commercial activity.[12]

These, and other letters filed with the Board, also highlighted key differences between bank holding companies and savings and loan holding companies, including:

- the statutory requirements for thrift subsidiaries of savings and loan holding companies to dedicate a certain percentage of business activities to mortgage and consumer lending;
- the enhanced prudential supervisory requirements that Congress chose to place on large bank holding companies, but not on savings and loan holding companies;
- the fact that many small savings and loan holding companies are merely corporate shells whose balance sheets consist primarily of the investment in the thrift subsidiary; and
- the fact that, during the course of the debate on the Dodd-Frank Act, Congress expressly rejected proposals to eliminate the savings and loan charter or limit the scope of activities permissible for savings and loan holding companies.

It was these distinctions between bank holding companies and savings and loan holding companies, as well as the diversity in the operations, activities and risks of savings and loan holding companies that originally caused the Office of Thrift Supervision ("OTS") to tailor the capital standards applicable to savings and loan holding companies rather than adopt a specific quantitative standard. As the OTS stated in its supervisory handbook for savings and loan holding companies, "the population of thrift holding companies is too diverse to develop a single, meaningful capital requirement."[13] The introductory section of that handbook also noted that savings and loan holding companies range from noncomplex companies with limited activities to complex, multinational corporations, and that this

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[9] Id.
[10] http://www.federalreserve.gov/SECRS/2011/May/20110525/OP-1416/OP-1416_052311_73333_478587321164_1.pdf
[11] http://www.federalreserve.gov/SECRS/2011/June/20110609/OP-1416/OP-1416_052311_73348_509124981536_1.pdf
[12] http://www.federalreserve.gov/SECRS/2011/May/20110524/OP-1416/OP-1416_052011_72828_546856046648_1.pdf
[13] OTS Holding Companies Handbook, § 100.8, March 2009.

universe of companies included securities brokers/dealers; insurance underwriters and agents; manufacturing firms; and retail companies.[14]

Despite the administrative record established in response to the Notice of Intent, the Agencies have proposed a capital regime for savings and loan holding companies that is the same as the regime applicable to bank holding companies. The Agencies offer a two-part rationale for this uniform approach to capital requirements for holding companies. First, the Agencies maintain that the Proposed Capital Rules do, in fact, take into consideration the unique characteristics, risks, and activities of savings and loan holding companies. Second, the Agencies state that the uniform approach would "mitigate potential competitive equity issues, limit opportunities for regulatory arbitrage, and facilitate comparable treatment of similar risks."[15]

The Associations do not believe the Proposed Capital Rules are sufficiently tailored to the unique characteristics, risks, and activities of savings and loan holding companies. The Proposed Capital Rules do include certain provisions related to the assets and exposures of insurance companies. However, even these provisions highlight the problems inherent in applying bank capital standards to savings and loan holding companies. Thus, it is not apparent how the Proposed Capital Rules recognize the unique characteristics, risks, and activities of a universe of savings and loan holding companies that is structured and operates quite differently than bank holding companies.

Moreover, the Associations do not agree that a set of rules that is more tailored to the characteristics, risks and activities of savings and loan holding companies would carry the negative consequences cited by the Agencies. In fact, the Agencies provide no empirical evidence to support concerns over potential competitive equity issues, opportunities for regulatory arbitrage, or the treatment of similar risks that might arise from alternative approaches to capital standards for savings and loan holding companies. The Agencies do not explain what potential competitive equity issues may arise that have not already arisen during the many years in which savings and loan holding companies have been subject to a qualitative standard rather than the quantitative standard applicable to bank holding companies. The Agencies do not cite any data that suggests that firms have engaged in regulatory arbitrage on the basis of capital regulation or are more likely to do so if the savings and loan holding companies were subject to an alternative capital approach. The Agencies provide no analysis of the different types of risks posed by the many and varied types of savings and loan holding companies.

Furthermore, there is no discussion in the Proposed Capital Rules of any alternative approaches to the establishment of capital standards for savings and loan holding companies other than the proposed uniform approach. As such, the Associations do not believe that the Agencies have made a sufficient administrative case for the establishment of uniform standards.

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[14] Id., § 100.

[15] 77 Fed. Reg. 52928 (Aug. 30, 2012).

The Associations believe that there are alternative approaches to capital standards that the Agencies could consider that would better align capital with the operations, activities and risks of savings and loan holding companies. One alternative would be to apply the principal of equivalency to savings and loan holding companies. In other words, the Agencies could accept the capital standards imposed on a savings and loan holding company by another regulator. This approach would only apply to those savings and loan holding companies that are subject to comprehensive capital standards imposed by another regulator, such as insurance companies that are subject to comprehensive risk-based capital standards imposed by state insurance authorities. It has an approach, however, that the Board has applied to foreign banks for over two decades.[16]

Another alternative would be for the Agencies to extend the intermediate holding company approach established in section 626 of the Dodd-Frank Act to all savings and loan holding companies. Section 626 requires grandfathered unitary savings and loan holding companies to establish intermediate holding companies to house their financial activities. Section 604 of the Dodd-Frank Act then provides that the intermediate holding company, but not the parent company, is treated as a savings and loan holding company and is subject to all applicable regulatory standards, including capital standards. Extending the organizational structure of section 626 to all savings and loan holding companies would avoid the imposition of bank capital standards on parent companies that may otherwise be subject to capital rules imposed by other regulators (e.g., insurance companies) or otherwise engage in non-banking activities (e.g., retailers). Some precedent for this approach may be found in the Board's Regulation LL, which permits savings and loan holding companies that are financial holding companies to satisfy the "well-capitalized" standard required of all financial holding companies at the subsidiary thrift level rather than the parent company level. [17]

The Associations believe that each of these alternatives is permissible under the general administrative power granted to the Board in section 10 of the Home Owners' Loan Act.[18] Moreover, these alternatives are not inconsistent with the Collins Amendment (discussed further below), which requires minimum risk-based and leverage capital requirements that are not less than the generally applicable risk-based and leverage capital requirements applicable to insured depository institutions under the prompt corrective regulations implementing section 38 of the Federal Deposit Insurance Act. State-based capital regimes for insurance companies would meet this standard, as would the application of the capital requirements at an intermediate holding company.

Should the Agencies decide to choose to disregard these reasonable and more effective alternatives, we urge the Agencies to delay the effective date of the Proposed Capital Rules for savings and loan holding companies until 2015, as discussed further below.

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[16] 12 U.S.C. §§1842(c), 1843(j), and 3015(d)(3)(B), and (j)(2).
[17] 12 C.F.R. § 238.2(s).
[18] 12 U.S.C. § 1467a(g).

We also urge the Agencies to clarify that whenever the Rules are effective, all savings and loan holding companies, regardless of size and scope of activities, will be able to comply with the standardized approach to capital, as finalized by the Agencies. We make this latter request for two reasons. First, it is not entirely clear from the Proposed Capital Rules what standards (Basel I or Basel III) would apply to a savings and loan holding company if the Rules were effective in 2013.[19] Second, we believe that it would not be appropriate to require any large savings and loan holding company that has not previously been subject to any regulatory capital requirements to comply immediately with the advanced approaches. Because of the operational and regulatory complexity associated with the advanced approaches, large bank holding companies have been given an extended period of time to migrate to that approach, including an opportunity to conduct extensive parallel runs. Large savings and loan holding companies face the same compliance challenges and should be given a similar opportunity to phase into the advanced approaches. This could be achieved by permitting all savings and loan holding companies to comply with the standardized approach and then designing a schedule that provides for large savings and loan holding companies to migrate, overtime, to the advanced approaches.

In summary, the Associations urge the Agencies to reconsider the proposed uniform approach to capital for holding companies. The Agencies have not made, and in our opinion, cannot make, a reasonable policy case for treating every savings and loan holding company like a bank holding company for capital purposes, especially, given the unique character, activities, and risks posed by certain savings and loan holding companies. Also, there are alternative approaches that the Agencies should consider prior to the adoption of any final standards for savings and loan holding companies. In order to fully evaluate these and any other possible alternatives, the Associations strongly recommend that the Agencies re-propose for comment those parts of the Proposed Capital Rules that relate to the treatment of savings and loan holding companies. Re-proposal also would permit the Agencies to seek public input on a schedule for phasing in the advanced approaches to the nation's largest savings and loan holding companies, should the Agencies decide not to design a capital framework that is more suited to the operations and activities of savings and loan holding companies.

II. The Agencies Cannot Ignore Key Parts of the Collins Amendment as they Apply to Savings and Loan Holding Companies and Should Extend the Exemption in the Collins Amendment for Small Bank Holding Companies to Small Savings and Loan Holding Companies

Certain features of the capital standards proposed for savings and loan holding companies are based upon section 171 of the Dodd-Frank Act. However, the Agencies have

[19] We also would note that some have read the use of the term "or" in section 30, Applicability, in Subpart D of the Standardized common rule to provide for an effective date of January 1, 2015 for the capital rules, rather than January 1, 2013. This ambiguity further illustrates the need for the Agencies to clarify that savings and loan holding companies are not subject to the rules until 2015, and that the rules applicable to savings and loan holding companies are the standardized rules.

failed to give full effect to the terms of section 171 of the Dodd-Frank Act and this needlessly creates compliance burdens for savings and loan holding companies.

Section 171 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 must not be less stringent than the standards applicable to insured depository institutions as of July 21, 2010.

Section 171 has its origins in the Senate debate on the Dodd-Frank Act. During that debate, the Senate agreed to an amendment that was intended, according to its author, Senator Collins, "to impose tough risk- and size-based capital standards on financial institutions as they grow in size or engage in risky business activities."[20]

Senator Collins' amendment, now commonly known as the "Collins Amendment," was endorsed by then FDIC Chairman Sheila Bair. In a letter to Senator Collins, Chairman Bair elaborated on the purpose of the amendment as follows:

> During the crisis, FDIC-insured subsidiary banks became the source of strength both to the holding company and holding company affiliates. Far from being a source of strength to banks as Congress intended, holding companies became a source of weakness requiring federal support. If, in the future, bank holding companies are to become sources of financial stability for insured banks, then they cannot operate under consolidated capital requirements that are numerically lower and qualitatively less stringent than those applying to insured banks. This amendment would address this issue by requiring bank holding companies to operate under capital standards at least as stringent as those applying to banks.[21]

During the conference between the House and Senate on the Dodd-Frank Act, several significant changes were made to the Collins Amendment. Three of those changes are relevant to savings and loan holding companies. One relates to the effective date of the Collins Amendment for savings and loan holding companies. Another relates, indirectly, to the application of the amendment to small savings and loan holding companies. The final change relates to the capital recognition of trust preferred securities by savings and loan holding companies. Each of these features of the final Collins Amendment and the relationship between these features and the Proposed Capital Rules is addressed below.

Congress Expressly Delayed the Application of the Collins Amendment to Savings and Loan Holding Companies for Five Years

During the conference on the Dodd-Frank Act, the conferees agreed to delay, for five years, the application of the capital standards for any depository institution holding

[20] Cong. Rec., S3459 (May 10, 2010).
[21] Cong. Rec., S3460 (May 10, 2010).

company that was not supervised by the Board as of May 19, 2010. This delay appears in section 171(b)(4)(D), which 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, except as set forth in subparagraphs (A) and (B), shall be effective 5 years after the date of enactment of this Act.[22]

Since no savings and loan holding company was supervised by the Board as of May 19, 2010, this provision applies to all savings and loan holding companies.[23] The provision obviously was intended to give such companies, which had not previously been subject to quantitative minimum capital requirements, much needed time to make the operational and systems changes necessary to comply with such requirements.

Yet, the Proposed Capital Rules do not incorporate this delayed effective date for savings and loan holding companies. In fact, the Agencies do not discuss section 171(b)(4)(D) in the Proposed Capital Rules. We doubt that this is an oversight since section 171(b)(4)(D) was highlighted in several comment letters filed with the Board in response to the April 2011 Notice of Intent, which is discussed above. Moreover, the Proposed Capital Rules acknowledge and incorporate a five-year delay in the effective date for the application of capital standards for foreign banking organizations that appears in section 171(b)(4)(E), immediately after section 171(b)(4)(D). We assume, therefore, that the Agencies are proposing to impose minimum capital standards on savings and loan holding companies prior to 2015 on the basis of the Board's more general authority to establish capital standards for savings and loan holding companies under the terms of the Home Owners' Loan Act.[24]

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[22] Dodd-Frank Act § 171(b)(4)(D); 12 U.S.C. § 5371(b)(4)(D). The "except as set forth in subparagraph (A)" clause in the Collins SLHC deferral period prevents SLHCs from issuing trust preferred securities during the period May 19, 2010 through July 20, 2015. Without such clause, the "requirements of this section" [all of Section 171] would not be effective for SLHCs until July 21, 2015, arguably moving the May 19, 2010 cut-off date – just for SLHCs – to July 21, 2015. With such clause, the May 19, 2010 cut-off date for trust preferred securities is immediately applicable to both BHCs and SLHCs (even though SLHCs are not subject to consolidated regulatory capital requirements until July 21, 2015).
The "except as set forth in subparagraph . . . (B)" clause in the Collins SLHC deferral period refers to the three year phase-in deduction period for grandfathered trust preferred securities that were issued by depository institution holding companies before May 19, 2010. Without such clause, the "requirements of this section" [again, all of Section 171] would not be effective for SLHCs until July 21, 2015, which would arguably start a three-year phase-in deduction period – just for SLHCs – beginning on July 21, 2015. With such clause, there is just one three-year phase-in deduction period that begins for both BHCs and SLHCs on January 1, 2013 (even though SLHCs are not subject to consolidated regulatory capital requirements until July 21, 2015). On July 21, 2015, – 31 months into the three-year phase-in deduction period – SLHCs become subject to consolidated regulatory capital requirements. At that time, SLHCs receive the benefit of the remaining 5 months of the three year phase-in deduction period.

[23] Also, for purposes of this provision, § 171 defined a depository institution holding company to include a savings and loan holding company. See § 171(a)(3).

[24] 12 U.S.C. §1467a(g)(1).

The Agencies cannot ignore the five year delay mandated by Congress in section 171(b)(4)(D). Several basic canons of statutory construction require the Agencies to implement the five year delay set forth in section 171(b)(4)(D): a statute should be read as a whole, and not selectively;[25] every word in a statute should be given effect (Congress is presumed to know how to write laws);[26] and specific terms in a statute override general terms.[27]

The canon that specific terms override general terms may be particularly relevant in this case if, as we assume, the Agencies are imposing the minimum standards on the basis of the Board's general authority to impose capital standards on savings and loan holding companies. While we recognize that authority, and believe that there is an appropriate role for that authority in addressing the treatment of small savings and loan holding companies (see below), it cannot be read to trump a more explicit provision in federal law, especially one that was enacted at the same time.

Even if section 171(b)(4)(D) had not been added to the Collins Amendment, we believe that the Agencies should provide savings and loan holding companies with more time to comply with the Proposed Capital Rules. Unlike bank holding companies, savings and loan holding companies have not been subject to a quantitative minimum standard and will need time to make the necessary policy, procedural and systems changes necessary to comply with such a standard. There is ample precedent for such a delay since the Agencies provided a three-year delay for bank holding companies when Basel I was initially adopted.

The Agencies Should Craft a Regulatory Exemption for Small Savings and Loan Holding Companies that Parallels the Statutory Exemption for Small Bank Holding Companies

During the conference of the Dodd-Frank Act, the conferees also agreed to exempt small bank holding companies, entirely, from the minimum capital standards required by the Collins Amendment.[28] This exemption was linked to a Board policy statement on the supervision of small bank holding companies, which requires all small bank holding companies to be well-capitalized.[29] This change is relevant to small savings and loan holding companies because it places small savings and loan holding companies at a competitive disadvantage to small bank holding companies.

The omission of an exemption for small savings and loan holding companies is clearly a drafting oversight by the Congress. As noted above, the statutory exemption for small bank holding companies is linked to a Board policy statement on the supervision of small bank holding companies. When Congress was writing the Dodd-Frank Act, however, the Board did not have supervisory authority over savings and loan holding companies and

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[25] *Brotherhood of Locomotive Engineers v. Atchison, T.&S.F.R.R.*, 516 U.S. 152, 157 (1996).
[26] *Astoria Federal Savings & Loan Ass'n. v. Solimino*, 501 U.S. 104, 112 (1991).
[27] *Fourco Glass Co.v.Transmirra Products Corp.*, 353 U.S. 222, 228 (1957).
[28] § 171(b)(5)(C).
[29] 12 C.F.R. Part 225, Appendix C.

did not gain that authority until the Act was passed. Thus, the drafters of the Dodd-Frank Act could not cite a parallel policy statement from the Board related to the supervision of savings and loan holding companies.

The competitive inequity of this oversight is obvious. Small savings and loan holding companies will be subject to the same capital standards that apply to many of the nation's larger banking organizations while similarly situated bank holding companies will not be subject to such rules. This will impose costs and compliance burdens on small savings and loan holding companies that are not borne by small bank holding companies. Also, as discussed further below, it would force small savings and loan holding companies to reduce their reliance on trust preferred securities while small bank holding companies will be able to continue to have such securities count toward their tier 1 capital requirement.

Additionally, the absence of an exemption for small savings and loan holding companies has policy implications. It likely will drive many of these companies to pursue a charter change in order to take advantage of the small bank holding company exemption, and such a result is contrary to public policy as it will reduce the number of savings associations dedicated to the provision of mortgage and consumer credit. It has been estimated that over 200 small savings and loan holding companies with over $40 billion in assets would be impacted by this drafting oversight.[30]

The Agencies have the authority to address this problem. Section 10(g) of the Home Owners' Loan Act, as amended by the Dodd-Frank Act, provides the Board with the power to "issue such regulations and orders, including regulations and orders related to capital requirements for savings and loan holding companies, as the Board deems necessary or appropriate to enable the Board to administer and carry out the purposes of this section, and to require compliance therewith and prevent evasions thereof."[31] We urge the Agencies to exercise this authority and craft a regulatory exemption for small savings and loan holding companies that eliminates this competitive inequity and public policy problem.

The Collins Amendment Grandfathers Trust Preferred Securities Issued Before May 19, 2010 by Savings and Loan Holding Companies with Less than $15 Billion in Assets

The final change to the Collins Amendment made by the conferees that is relevant to savings and loan holding companies relates to the capital treatment of trust preferred securities and other non-qualified securities. Section 171 limits the ability of depository institution holding companies to recognize trust preferred and other non-qualified securities for purposes of the minimum risk-based and leverage capital standards required by the section. However, the conferees added section 171(b)(4)(C) to permit savings and

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[30] According to Sandler O'Neill Partners there are 219 savings and loan holding companies with less than $500 million in consolidated assets and these companies collectively have assets of $42 billion, citing SNL Financial data as of December 31, 2010.
[31] 12 U.S.C. §1467a(g).

loan (and bank) holding companies with less than $15 billion in assets, and all mutual holding companies, to continue to recognize such securities for purposes of tier 1 capital if those securities were issued before May 19, 2010. Section 171(b)(4)(C) reads as follows:

> (C) DEBT OR EQUITY INSTRUMENTS OF SMALLER INSTITUTIONS. – For debt or equity instruments issued before May 19, 2010, by depository institution holding companies with total consolidated assets of less than $15,000,000,000 as of December 31, 2009, and by organizations that were mutual holding companies on May 19, 2010, the capital deductions that would be required for other institutions under this section are not required as a result of this section.

The Proposed Capital Rules, on the other hand, do not recognize this permanent exemption and call for smaller holding companies to phase out any capital recognition of trust preferred securities over a ten year period. As discussed above, the Agencies cannot ignore a specific directive from Congress. Clearly, Congress recognized the importance of trust preferred and other non-qualifying capital instruments for smaller holding companies, which have challenges in accessing the capital markets. Accordingly, we urge the Agencies to modify the Proposed Capital Rules to give full effect to the permanent exemption established in section 171(b)(4)(C).

III. The Treatment of the Assets and Exposures of Insurance Companies

The Agencies have proposed several provisions designed to address insurance assets and exposures held by savings and loan holding companies. These provisions only highlight the problems inherent in applying a capital regime designed for bank holding companies to savings and loan holding companies that are insurance companies. As such, these provisions reinforce our recommendation that the Agencies propose alternative capital regimes for savings and loan holding companies based upon either an equivalency standard or through the application of the requirements to an intermediate holding company.

Policy Loans

The Agencies have proposed a 20 percent risk weight for policy loans. The stated rationale for this proposed treatment is that policy loans are similar to cash secured loans. In the Proposed Capital Rules, however, cash secured loans are assigned a zero risk weight. Thus, assigning a 20 percent risk weight to policy loans is overly conservative, especially since policy loans include a set off right against policy benefits.

Separate Accounts

The Agencies have proposed that the risk weight for separate accounts be based upon whether the account is guaranteed or non-guaranteed. The Agencies also have proposed that in order for an account to be treated as non-guaranteed, and receive a zero risk weight, an insurance company may not maintain a reserve against the account. This proposed treatment of separate accounts is flawed on two levels. First, it is not appropriate to treat all guaranteed accounts the same since the nature of the guarantee can vary with different types of products. For example, a guaranteed minimum death benefit that is part of a variable annuity should not trigger increased capital for the entire separate account. The guarantee runs to the death benefit, which is typically a fraction of the value of the separate account. A risk-based approach to capital should recognize the different levels of risk associated with different types of guaranteed accounts.

Second, the establishment of a reserve should not prevent a separate account from being treated as non-guaranteed. State insurance laws require reserves for variable products that include separate accounts and these reserves are backed by general account assets, not the assets of the separate account. Thus, the mere existence of a reserve should not trigger a capital requirement.

Surplus Notes

The Agencies have proposed that surplus notes be eligible for inclusion in tier 2 capital. Surplus notes are an important source of capital for non-public insurers, and do have key loss absorbency characteristics. Under New York law, for example, surplus notes are unsecured; they are not subject to set-off; they are not included as legal liabilities of the insurer; and all interest and principal payments must be made out of free and divisible surplus of the insurer and may only be made with the prior approval of New York authorities.[32] We see no reason why these instruments should not automatically qualify for inclusion in tier 2.

Additionally, Congress has encouraged the Agencies to accommodate the capital structures of mutual and fraternal insurance companies that issue such instruments. The Senate Report accompanying the Dodd-Frank Act states that in implementing section 616 of the Act, which gives the Board authority to issue capital standards for savings and loan holding companies, the Board "should take into account regulatory accounting practices and procedures applicable to, and capital structure of, holding companies that are insurance companies (including mutual and fraternals)..."[33]

Capital Deduction for Insurance Underwriting Subsidiaries

The Agencies have proposed to require a savings and loan holding company to deduct the minimum regulatory capital requirement of any insurance underwriting subsidiary from the company's total capital.[34] This proposed deduction would be divided equally between tier 1 and tier 2 capital.

Such a requirement is inherently unfair to savings and loan holding companies engaged in the business of insurance. No similar deduction is required for a depository

[32] N. Y. Ins. Law § 1307.
[33] S. Rep. No. 111-176 (2010).
[34] The Agencies, without any explanation, completely disregard the situation and implications where a savings and loan holding company is a functionally regulated insurance company.

institution subsidiary or a securities subsidiary of a holding company. Thus, the proposal effectively discourages holding companies from engaging in the business of insurance. Such a result is contrary to the terms of the Gramm-Leach-Bliley Act, which authorized affiliations between banks and insurers, and public policy. It is well documented that we are an underinsured nation[35], and public policy should promote, not discourage, the provision of insurance to consumers and businesses.

Congress addressed a similar problem in the Collins Amendment when it gave the Board the authority not to require a capital deduction by a holding company for an investment made by an insured depository institution in a functional subsidiary.[36] The Agencies should apply the same principle in the case of direct investments in insurance companies by a holding company and not require the holding company to deduct the insurance company's capital from the total capital requirement.

SAP Accounting

Compliance with the Proposed Capital Rules would require savings and loan holding companies to meet GAAP financial standards. Many savings and loan holding companies, especially those organized in mutual or fraternal form, do not prepare GAAP financial statements. Instead, these companies prepare financial statements in accordance with SAP standards developed by state regulators. Companies that follow SAP standards should be able to continue to do so, just as the Board has permitted foreign banks to rely upon their home country's accounting standards. Such an accommodation also would be consistent with the directive to the Board in the Senate Report accompanying the Dodd-Frank Act, which, as noted above, calls for the Board 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)..."[37]

IV. The Agencies Should Maintain the Accumulated Other Comprehensive Income (AOCI) Filter

Current capital rules provide for the neutralization of unrealized gains and losses on debt securities that are available for sale. The Proposed Capital Rules would remove this "filter" and require adjustments to common equity tier 1 capital based upon unrealized gains and losses in these securities. We are concerned that this proposed change would increase the volatility of capital ratios. For example, insurance companies typically hold long-term debt securities for investment purposes and such securities are highly sensitive to changes in interest rates. Thus, as interest rates fluctuate, an insurance company could experience wide swings in its required capital. This would create a significant capital planning challenge. It also would have the unintended consequence of encouraging companies to transition out of long-term debt securities into securities with shorter

[35] See, for example, "Too Many People Lack Adequate Life Insurance," J.D. Power & Associates, February 24, 2012, http://www.jdpower.com/content/detail.htm?jdpaArticleId=346.
[36] Section 171(b)(3).
[37] S. Rep. No. 111-176 (2010).

durations, which would negatively impact the market for long-term Treasury securities, long-term mortgage securities, and long-term municipal securities. The Associations urge the Agencies to maintain the AOCI filter.[38]

V. The Agencies Should Avoid Overly Conservative Capital Standards for Residential Mortgage Exposures

As noted earlier in this letter, savings and loan holding companies and the thrift subsidiaries of savings and loan holding companies have a statutory obligation to dedicate a certain percentage of their lending business to residential mortgages and other consumer loans. Savings and loan holding companies also face rather severe penalties if their thrift subsidiaries fail to meet this obligation.[39] Accordingly, the capital treatment of residential mortgage exposures is of special interest to savings and loan holding companies.

The Agencies have proposed sweeping changes to the capital treatment of residential mortgages. The Associations recognize that losses associated with residential mortgage loans and mortgage-backed securities contributed to the recent financial crisis. However, we are concerned that the Proposed Capital Rules could significantly diminish new mortgage lending and, thereby, have negative consequences for homebuyers and the economy as a whole. For example, the Proposed Capital Rules would, in some cases, impose considerably higher risk weights on some types of secured mortgages than would be applied to unsecured loans. Such changes could have a profound effect on the way that institutions provide mortgages, which, in turn, could result in far greater incentives to sell loans to government-backed entities and to reduce the bank holdings of such loans; far fewer loans being extended to all but the most creditworthy; and a substantial reduction in home equity lending—which, despite recent losses, continues to be an important on-balance sheet business for a broad range of banks, from large to small.

Yet, despite these potentially far-reaching changes, the Agencies offer only conclusory statements to justify the new risk-weightings, with no empirical support for the changes. The Agencies have not conducted an empirical study to evaluate the impact of the Rules on the banking industry, consumer and commercial borrowers, or the overall economy.[40] The Associations urge the Agencies to conduct such an empirical study.

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[38] For additional detail on the problems associated with the removal of the AOCI filter, please see the joint trade association comment letter of October 22, 2012 submitted by The Financial Services Roundtable, the American Bankers Association and the Securities Industry and Financial Markets Association: "Comment Letter on Proposals to Comprehensively Revise the Regulatory Capital Framework for U.S. Banking Organizations".
and the letter from the American Bankers Association and The Clearinghouse to Arthur W. Lindo, Senior Associated Director, Board of Governors, March 1, 2012, which is available at http://www.theclearinghouse.org/index.html?f=073582.

[39] See 12 U.S.C. § 1467a(m)(3)(C).

[40] For additional detail on the treatment of residential mortgages, please see the joint trade association comment letter of October 22, 2012 submitted by The Financial Services Roundtable, the American Bankers Association and the Securities Industry and Financial Markets Association: "Comment Letter on Proposals to Comprehensively Revise the Regulatory Capital Framework for U.S. Banking Organizations".

VI. Conclusion

The Associations thank you for considering the comments and recommendations set forth in this letter. If you have any questions or need further information, please do not hesitate to contact:

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Sincerely,

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